

18
TRANSCRIPT OF RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1923

No. 567

**BOARD OF PUBLIC UTILITY COMMISSIONERS AND
HARRY V. OSBORNE, JOSEPH F. AUTENREITH,
ET AL., ETC., APPELLANTS,**

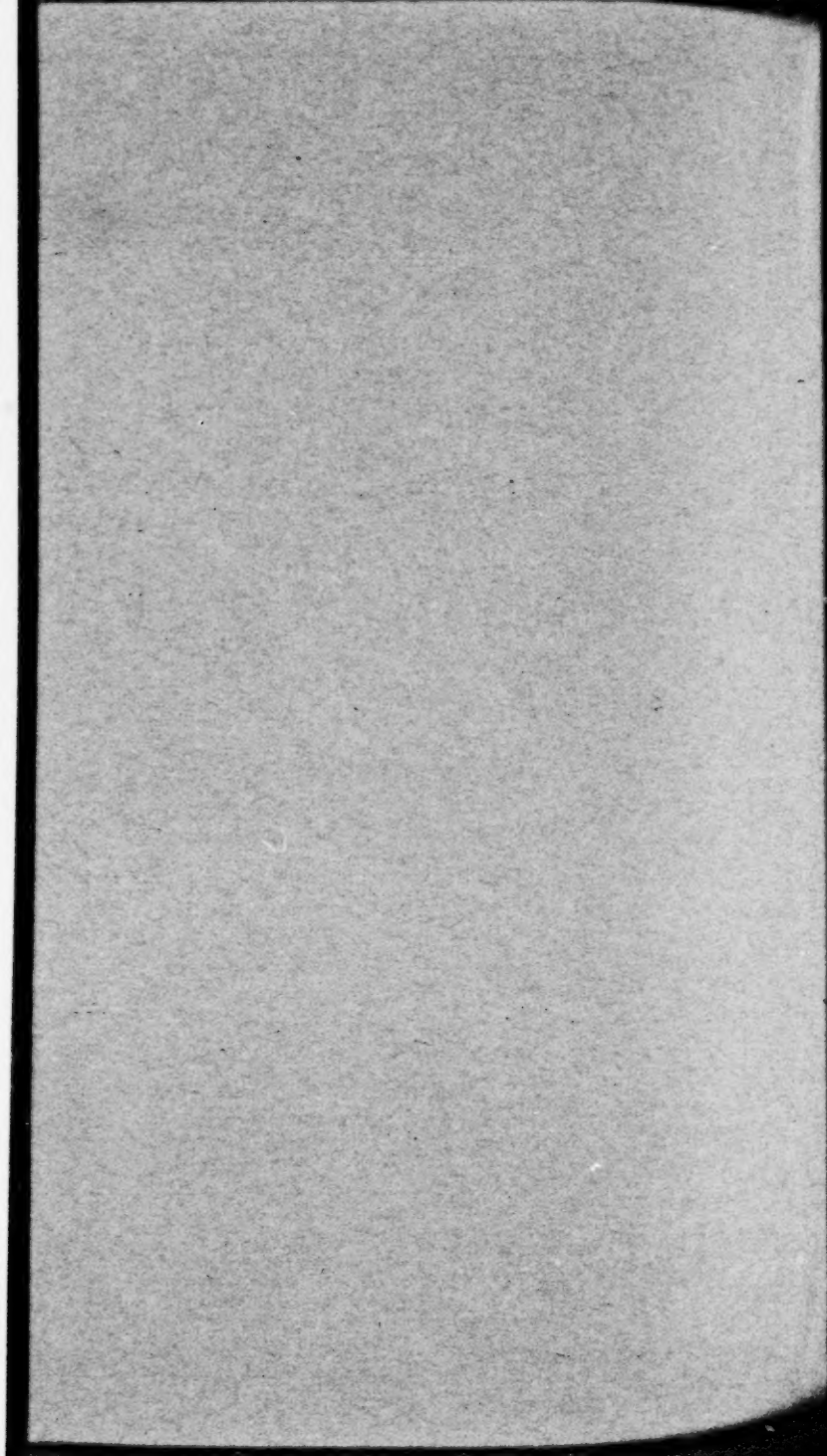
vs.

NEW YORK TELEPHONE COMPANY

**APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR
THE DISTRICT OF NEW JERSEY**

FILED JUNE 24, 1925

(31,290)



(31.290)

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1925

No. 567

BOARD OF PUBLIC UTILITY COMMISSIONERS AND
HARRY V. OSBORNE, JOSEPH F. AUTENREITH,
ET AL., ETC., APPELLANTS,

vs.

NEW YORK TELEPHONE COMPANY

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR
THE DISTRICT OF NEW JERSEY

INDEX

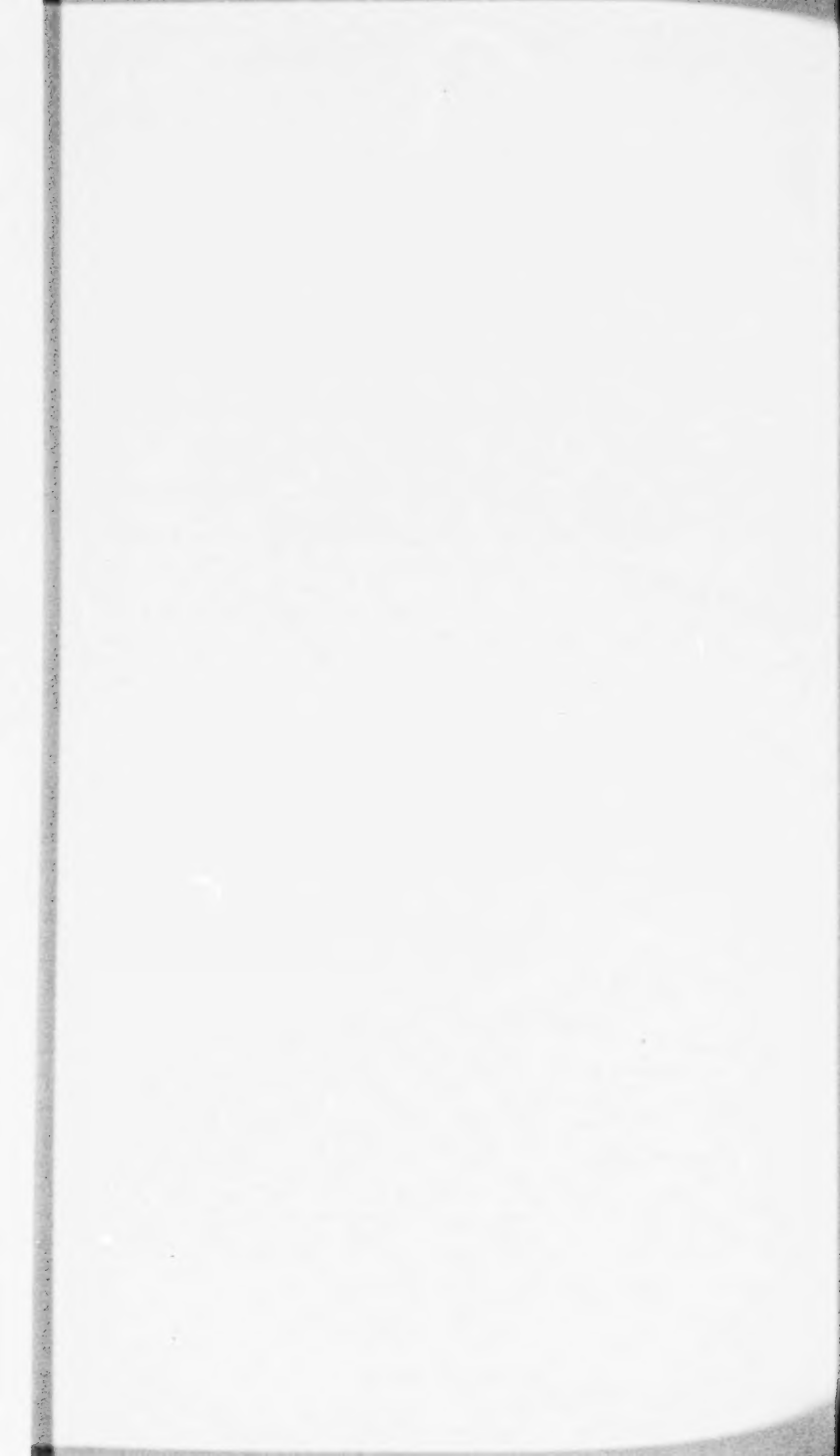
	Original	Print
Record from the district court of the United States, district of New Jersey.....	1	1
Docket entries.....	1	1
Summons and marshal's return.....	3	2
Bill of complaint.....	4	3
Exhibit "A"—Decision of Board of Public Utility Com- missioners, State of New Jersey, in the matter of schedules filed by the New York Telephone Co. in- creasing rates and charges.....	18	16
Affidavit of Frankland Briggs.....	64	70
Exhibit F. B. No. 1—Order of board, dated March 11, 1924, suspending increase in rates.....	65	71
Exhibit F. B. No. 2—Order of board, dated June 30, 1924, further suspending increase in rates.....	66	72
Exhibit F. B. No. 3—Copy of letter, dated October 14, 1924, addressed to H. V. Osborne, president of board, by Mr. Briggs, stipulating that suspension be ex- tended to January 1, 1925.....	67	72

	Original	Print
Affidavit of Henry C. Carpenter.....	68	73
George W. Whittemore.....	72	78
Harland A. Trax.....	77	83
Andrew Sangster.....	86	94
Jesse A. Moir.....	94	103
Exhibit J. A. M-1—Comparison of trends, wages, wholesale commodity prices and average exchange and toll revenue per station since 1910.....	96	104
Exhibit J. A. M-2—Statistics represented diagram- matically by chart on Exhibit J. A. M-1, supported and supplemented by tabular statements.....	98	104
Affidavit of Harry M. Addinsell.....	103	112
Affidavit of William Henry Blood, Jr.....	105	114
Exhibit W. H. B-1—Curves showing trend of cost of light and power properties.....	108	117
Exhibit W. H. B-2—Curves showing trend of cost of electric railway properties.....	110	117
Affidavit of George W. Whittemore.....	112	117
Exhibit G. W. W. No. 1—Summary showing average service life of common battery offices.....	122	129
Exhibit G. W. W. No. 2—Summary showing average ages as of 12-31-23 of common battery offices.....	122a	130
Affidavit of Andrew Sangster.....	123	131
Exhibit A. S. No. 1—Copy of order of Interstate Com- merce Commission, dated December 10, 1912, pre- scribing uniform system of accounts for telephone companies	130a	139
Exhibit A. S. No. 2—Sections 23 and 24 of Interstate Commerce Commission uniform system of accounts..	132	140
Exhibit A. S. No. 3—Letter of Interstate Commerce Commission addressed to all carriers concerned con- cerning charges for depreciation.....	133a	142
Affidavit of Henry R. Gabay.....	135	143
Exhibit H. R. G-1—Comparison of exchange rate levels and cost of living, years 1914-1924.....	138	145
Affidavit of Tage P. Sylvan.....	140	146
Exhibit T. P. S. No. 1—Copy of license contract.....	149	155
Affidavit of James T. Moran.....	164	168
Affidavit of Benjamin T. McBurney.....	167	171
Answer of defendants Harry V. Osborne, Joseph F. Auten- rieth, and Frederick W. Gnichtel.....	171	172
Answer of defendant Board of Public Utility Commis- sioners	175	172
Affidavit of Cyrus G. Hill.....	183	187
Exhibit No. 1—Chart showing comparison of existing depreciation reserves under company's rates with those ordered by board.....	209½	204
Exhibit No. 2—Chart showing growth of depreciation reserves for retirement of plant in service, December 31, 1924.....	210	204

INDEX

iii

	Original	Print
Exhibit No. 3—Chart showing depreciation reserves for ultimate retirement of Telephone Company's property with additions to December 31, 1926.....	210½	204
Exhibit No. 4—Example showing equivalence as regards distribution of retirements and average life...	211	205
Exhibit No. 5—Example showing distribution of retirements, retired at different ages.....	211½	206
Affidavits of James G. Wray.....	212	207
Affidavit of John P. Petty.....	228½	224
Exhibit—Comparison of average annual wholesale commodity index prices.....	231½	228
Affidavits of James G. Wray.....	235	232
Opinion, Buffington, J.....	242	237
Order for interlocutory injunction.....	249	240
Injunction and marshal's return.....	253	242
Bond on injunction.....(omitted in printing) ..	256	243
Citation and service.....(omitted in printing) ..	261a	243
Petition for appeal and order allowing same.....	262	243
Assignments of error.....	264	244
Citation and service.....(omitted in printing) ..	268	
Stipulation substituting defendant.....	270	246
Stipulation re transcript of record.....	272	246
Clerk's certificate.....	273	247



[fol. 1] **IN UNITED STATES DISTRICT COURT, DISTRICT
OF NEW JERSEY**

E—1062

NEW YORK TELEPHONE COMPANY

vs.

BOARD OF PUBLIC UTILITY COMMISSIONERS and CHARLES BROWN,
JOSEPH F. AUTENREITH and FREDERICK W. GNICHTEL, Consti-
tuting said Board

Docket Entries

Jan.	29,	1925.	Bill of Complaint filed.
"	"	"	Affidavit of plaintiff on application for Interlocu- tory Injunction filed.
"	"	"	Order to Show Cause why Interlocutory Injunc- tion should not issue, &c. filed.
Feby.	5,	"	Subpoena issued.
"	"	"	Affidavits of Plaintiff filed.
"	18,	"	Subpoena returned, served Feby. 6, 13, & 17 and filed.
"	6,	"	Proof of Service of Order filed.
"	"	"	Notice of Hearing filed.
"	9,	"	Hearing on motion for continuance of Order to Show Cause, Ordered that hearing be adjourned to day to be fixed.
"	10,	"	Proofs of service of printed additional Affidavits filed.
"	11,	"	Notice of Application for Continuance filed.
Jan.	31,	"	Order convening Court under Section 266 of Judi- cial Code, filed.
Mar.	6,	"	Notice of hearing filed.
"	13,	"	Answer of Board of Public Utility Commissioners filed.
"	16,	"	Hearing on Order to Show Cause why Injunction should not issue.
"	17,	"	Hearing on Order to Show Cause why Injunction should not issue.
[fol. 2]			Decision reserved.
Mar.	16,	1925.	Answer of H. V. Osborne, Joseph F. Autenreith and F. W. Gnichtel filed.
"	"	"	Affidavits of defendants filed.
May	2,	"	Opinion filed.
"	12,	"	Hearing on motion for settlement of Final Decree.
"	"	"	Order substituting party defendant filed.
"	"	"	Order for Interlocutory Injunction filed.
"	"	"	Order of Reference filed.

May	23,	1925.	Bond on Preliminary Injunction filed.
"	"	"	Interlocutory Injunction issued.
"	26,	"	" " returned, served and filed.
"	29,	"	Assignment of Errors filed.
"	"	"	Appeal and Allowance filed.
June	4,	"	Citation filed.

[fol. 3] IN UNITED STATES DISTRICT COURT

SUMMONS AND MARSHAL'S RETURN—Filed Feb. 18, 1925

To Board of Public Utility Commissioners and Harry V. Osborne, Joseph F. Autenreith, and Frederick W. Gnichtel, constituting said board, Greeting:

We command you, that you appear in manner and form required by law in our District Court of the United States for the District of New Jersey, as a Court of Chancery, within twenty days from date of service hereof upon you, to answer to a bill of complaint exhibited against you in our said Court by New York Telephone Company and to do further and receive what our said Court shall have considered in that behalf; and this you are not to omit, under the penalty that may fall thereon.

Witness the Honorable John Rellstab, Judge of said Court, this Fifth day of February, 1925.

George T. Cranmer, Clerk, by L. M. Zarp, Deputy. (Seal.)

MEMORANDUM.—The defendant is to file his Answer or other Pleading in the suit, in the Clerk's Office, Trenton, N. J., on or before the twentieth day after service, excluding the day thereof, otherwise the bill may be taken pro confesso.

Served the within subpoena ad respond upon the Board of Public Utility Commissioners, by delivering to and leaving with Alfred N. Barier, the secretary of said board, a copy thereof, at Trenton, in the district of New Jersey, on the 6th day of February, A. D. 1925, at the same time showing him this original with the seal of the court attached, and informing him of the contents thereof.

J. H. Mulheron, United States Marshal. Anna T. Muldoon, Deputy.

Served the within subpoena ad respond by delivering to and leaving with Harry V. Osborne a copy thereof at Newark and by delivering to and leaving with Joseph Autenreith a copy thereof at Jersey City each in the district of N. J. on Feb. 13th, 1925 and at the same time showing the said persons this original with the seal of the court attached and informing the said persons of its contents.

James H. Mulheron, U. S. Marshal, by Charles A. Denner, Deputy.

Served the within Subpœna ad Respond upon Frederick W. Gnichtel by delivering to and leaving with him personally a copy thereof at Trenton, in the District of New Jersey on the 17th day of Feb. 1925, at the same time showing said person this original with the seal of the court attached, and informing him of the contents thereof.

James H. Mulheron, U. S. Marshal. Morris Osrowitz, Deputy.

[File endorsement omitted.]

[fols. 4 & 5]

[File endorsement omitted]

[fol. 6]

IN UNITED STATES DISTRICT COURT

[Title omitted]

BILL OF COMPLAINT—Filed Jan. 29, 1925

To the Honorable the Judges of the United States District Court for the District of New Jersey:

The New York Telephone Company, plaintiff, brings this its Bill of Complaint against the defendants Board of Public Utility Commissioners and Harry V. Osborne, Joseph F. Autenreith and Frederick W. Gnichtel, constituting said Board, and for its cause of action alleges:

I. The plaintiff, New York Telephone Company, is a corporation duly created and existing under and pursuant to the laws of the State of New York, having its principal office at No. 15 Dey Street in the Borough of Manhattan, City, County and State of New York, and having its principal office in the State of New Jersey at No. 281 Washington Street in the City of Newark, County of Essex, and during all the times herein referred to has owned and operated a telephone system in and generally throughout the Counties of Hudson, Essex, Bergen, Passaic, Morris, Union, Middlesex, Somerset, Monmouth, Sussex and parts of Ocean and Burlington Counties in the State of New Jersey and also throughout the State of New York and in a portion of the State of Connecticut, furnishing to the public telephone exchange service and both intrastate and interstate telephone toll service. Telephone exchange service is service between telephone stations within the same local service area, and telephone toll service is telephone service between telephone stations located in different local service areas. The territory in the State of New Jersey in which plaintiff operates is divided into a number of local service areas. The telephone exchange service and the intrastate telephone toll service together constitute the whole of plaintiff's telephone service between points within the State of New Jersey.

II. The defendants Harry V. Osborne, Joseph F. Autenreith and Frederick W. Gnichtel are the persons constituting the Board of Public Utility Commissioners, which is an administrative body duly created by an act of the Legislature of New Jersey entitled "An Act concerning public utilities; to create a Board of Public Utility Commissioners and to prescribe its duties and powers," approved April 21, 1911, and is charged with the duty of carrying out the provisions of the said statute and its supplements and amendments. The acts of these defendants hereinafter complained [fol. 7] of were taken by them under the pretended authority of said Act.

III. This suit is of a civil nature in equity and is brought for the purpose of enjoining the enforcement of a certain order of said Board of Public Utility Commissioners, dated December 31, 1924, (including a decision of the same date made a part of said order by reference therein), such order and decision being hereto annexed and made a part hereof and marked "Exhibit A," wherein it is found and determined that certain proposed rates for telephone service within the State of New Jersey, filed by plaintiff on March 6, 1924, to become effective April 1, 1924, and subsequently suspended by orders of said Board of Public Utility Commissioners, are unjust and unreasonable, and said proposed rates are disallowed, and wherein it is ordered that the rates for telephone service now being charged be continued in force from and after January 1, 1925; and that the plaintiff keep certain of its accounts, relating particularly to the reserves for depreciation and for the amortization of intangible capital, and make certain prescribed entries therein, in conformity with the requirements of said order, as therein and hereinafter more fully set forth.

This suit arises under the Constitution and laws of the United States, in that:

First. The rates for telephone service which said order requires to be continued in effect are confiscatory of plaintiff's property used or useful in furnishing telephone service within said state to the public, and said order, therefore, deprives plaintiff of its property without due process of law and denies plaintiff the equal protection of the laws, in violation of its rights under the Fourteenth Amendment to the Constitution of the United States, and said order is, therefore, null and void, as is shown more fully hereinafter.

Second. The rates per cent fixed and prescribed in said order for the charges to Depreciation Expense and to Amortization of Landed Capital, and clearing accounts, (concurrent credits to be made to the corresponding reserve accounts), are inadequate, and compliance with said order in this respect would deprive plaintiff of its property without due process of law and deny plaintiff the equal protection of the laws in violation of its rights under the Fourteenth Amendment to the Constitution of the United States, and said order is, therefore, null and void, as is shown more fully hereinafter.

Third. The provisions of said order whereby the current net earnings of the plaintiff are theoretically required to be increased, so to be shown in the accounts, by making charges to expense for depreciation and for amortization of landed capital that are less than the current depreciation expense and capital amortization as found and determined by said order, and less than the true and correct current amounts for those items, are confiscatory of plaintiff's said property and, if enforced, would deprive plaintiff of its property without due process of law and deny plaintiff the equal protection of the laws violation of its rights under the Fourteenth Amendment to the Constitution of the United States, and said order is, therefore, null and void, as is shown more fully hereinafter.

Fourth. The provisions of said order, relating to the accounting for depreciation expense and amortization of capital and prescribing the rates therefor and the entries to be made by plaintiff in its accounts, constitute an interference with interstate commerce in contravention of Section 8 of Article I of the Constitution of the United States, and are contrary to the provisions of Paragraph 5 of Section 20 of the Interstate Commerce Act, as amended, and contrary to the orders of the Interstate Commerce Commission issued pursuant to said Act, and said order is, therefore, null and void, as is shown more fully hereinafter.

The amount in controversy in this suit exceeds the sum or value of Three Thousand Dollars (\$3,000) exclusive of interest and costs.

IV. The rates for telephone exchange service now in effect and prescribed to be effective from and after January 1, 1925, by said order of defendants have been in effect for upwards of ten years, except for some reductions in rates made in the years 1914 and 1915 and some increases made in the year 1919 during the period when plaintiff's property was in the possession and under the supervision and control of the United States Government, which said increases and reductions practically offset each other in their effect upon the revenues of plaintiff.

The plaintiff's existing rates for intrastate telephone toll service have been in effect for upwards of ten years with the exception that a somewhat lower schedule of toll rates was in force from July 1, 1918, to January 21, 1919.

V. On March 6, 1924, plaintiff filed with defendants schedules of exchange rates making increases in such rates generally throughout the territory in New Jersey operated by it. The rates were filed to become effective April 1, 1924. With said rates in effect as filed, plaintiff would not only fail to earn anything in excess of a fair return upon the fair and reasonable value of its property in the State of New Jersey used or useful in furnishing the intrastate telephone service, but would not even earn such fair return. No increase in rates for toll service was included in the schedules so filed by plaintiff on March 6, 1924.

The said Board by an order dated March 11, 1924, suspended the

proposed rates until July 1, 1924, pending an investigation into their reasonableness. By a further order dated June 30, 1924, the suspension was continued until October 1, 1924; at that time the investigation was uncompleted and the period of suspension was extended by and with the consent of the plaintiff to January 1, 1925. On December 31, 1924, the Board issued the order above referred to, effective January 1, 1925, finding the rates filed by the plaintiff on March 6, 1924, unjust and unreasonable and prescribing that the existing rates be kept in force from and after the effective date of the order and making such other findings and determinations as more fully appear in said order.

VI. The fair and reasonable value of the property of the plaintiff in the State of New Jersey at the date of said order and now being used or useful in furnishing its intrastate telephone service to the public and exclusively devoted to the rendition of that service is \$74,600,000.

The cost of reproduction of said property as of said date is \$84,400,000.

The cost of said property to plaintiff as of said date is \$64,452,242.

The foregoing statement of the cost to the plaintiff of said property includes nothing on account of the item of franchises or the item known as "going value."

The foregoing statements of cost of reproduction and fair and reasonable value of said property include nothing on account of the item of franchises but do include an item of going concern value to the amount of \$9,034,438.

[fol. 9] VII. Plaintiff's net earnings derived from its intrastate telephone business within the State of New Jersey under the rates which the said order requires the plaintiff to continue in effect, as aforesaid, stated in rate per cent. annual return upon the fair and reasonable value of the property used or useful in furnishing said service and exclusively devoted to the rendition thereof during each of the following periods have been as follows:

For the year 1922.....	0.76%
" " " 1923.....	1.10%
" " " 1924.....	0.42%

VIII: Plaintiff's net earnings derived from its intrastate telephone business within the State of New Jersey under the rates which the said order requires the plaintiff to continue in effect, as aforesaid, stated in rate per cent. annual return upon the cost of the property used or useful in furnishing said service and exclusively devoted to the rendition thereof during each of the following periods have been as follows:

For the year 1922.....	0.97%
" " " 1923.....	1.35%
" " " 1924.....	0.59%

At all of the times aforesaid the fair and reasonable value of said property has been an amount substantially in excess of its cost.

IX. The fair and reasonable value of the property of plaintiff in the State of New Jersey at the date of said order and now being used or useful in furnishing telephone service, both intrastate and interstate, to the public and exclusively devoted to the rendition of that service is \$97,286,319.

The cost of reproduction of said property as of said date is \$110,303,367.

The cost of said property to plaintiff as of said date is \$82,899,597.

The foregoing statement of the cost to the plaintiff of said property includes nothing on account of the item of franchises or the item known as "going value."

The foregoing statements of cost of reproduction and fair and reasonable value of said property include nothing on account of the item of franchises but do include an item of going concern value to the amount of \$11,782,000.

X. Plaintiff's net earnings derived within and for the State of New Jersey from both its intrastate and interstate telephone business, stated in rate per cent. annual return upon the fair and reasonable value of the property used or useful in furnishing said service and exclusively devoted to the rendition thereof during each of the following periods, have been as follows:

For the year 1922.....	4.34%
" " " 1923.....	4.42%
" " " 1924.....	3.75%

XI. Plaintiff's net earnings derived within and for the State of New Jersey from both its intrastate and interstate telephone business, stated in rate per cent. annual return upon the cost of the property used or useful in furnishing said service and exclusively devoted to [fol. 10] the rendition thereof during each of the following periods, have been as follows:

For the year 1922.....	5.54%
" " " 1923.....	5.47%
" " " 1924.....	4.47%

At all of the times aforesaid the fair and reasonable value of said property has been an amount substantially in excess of its cost.

XII. The telephone business of the plaintiff in the State of New Jersey and elsewhere has been conducted efficiently and economically during all the times herein referred to and is now being so conducted.

XIII. The fair annual return which the plaintiff is entitled to earn under rates imposed upon it by public authority is an amount equal to not less than eight per cent. (8%) of the fair and reasonable value of its property used or useful in the rendition of the service covered by the rates in question.

XIV. Plaintiff's net earnings derived from its total intrastate telephone business within the State of New Jersey under the rates which

the said order requires the plaintiff to continue in effect, as aforesaid, have been for the periods hereinafter stated less than eight per cent. (8%) of the average fair and reasonable value of the property used or useful in and exclusively devoted to the rendition of said service by the following amounts:

For the year	1922	\$3,980,468
" " "	1923	\$4,278,374
" " "	1924	\$5,304,779

Said net earnings have been less than eight per cent. (8%) of the cost of the property used or useful in and exclusively devoted to the rendition of said service by the following amounts:

For the year	1922	\$3,047,078
" " "	1923	\$3,343,523
" " "	1924	\$4,447,858

XV. Plaintiff's net earnings derived within and for the State of New Jersey, from both its intrastate and interstate telephone service, have been for the periods hereinafter stated less than 8% of the fair and reasonable value of the property used or useful in and exclusively devoted to the rendition of said service by the following amounts:

For the year	1922	\$2,673,238
" " "	1923	\$2,901,949
" " "	1924	\$3,870,732

Said net earnings have been less than 8% of the cost of the property used or useful in and exclusively devoted to the rendition of said service by the following amounts:

For the year	1922	\$1,405,311
" " "	1923	\$1,654,468
" " "	1924	\$2,690,517

XVI. Plaintiff is and during all the times herein referred to has been a telephone company engaged in the transmission of intelligence by wire between points in and throughout the said counties of the State of New Jersey in which its telephone system is situated, as hereinbefore averred, and points in and throughout all other states and territories of the United States and the District of Columbia, and has been and is a common carrier engaged in interstate commerce, as defined and provided in the Interstate Commerce Act, as from time to time amended, and subject to the jurisdiction of the Interstate Commerce Commission, as provided in said Act. During all said times, plaintiff's telephone system has been used in and devoted to the transmission of both interstate and intrastate communications, according to the requirements of its subscribers and patrons. Its said system has at all times been constructed and operated so as to furnish at all its telephones and to all its patrons and subscribers facilities for both interstate and intrastate communications and its plant and system in the state of New Jersey constitute facilities used and useful in interstate commerce.

By valid order entered December 10, 1912, effective January 1, 1913, the Interstate Commerce Commission, pursuant to the provisions of said Interstate Commerce Act, as amended, adopted and promulgated the "Uniform System of Accounts for Telephone Companies" (Class A and B), and said order has ever since remained in force and effect. Said order provides, among other things, the following:

"It is further ordered that the said Uniform System of Accounts for Telephone Companies with the text pertaining thereto, be, and the same is, hereby prescribed for the use of telephone companies having annual operating revenues exceeding \$50,000, subject to the provisions of the act to regulate commerce, as amended, in the keeping and recording of their accounts; that each and every such carrier and each and every receiver or operating trustee of any such carrier be required to keep all accounts in conformity therewith; and that a copy of the said first issue be sent to each and every such carrier and to each and every receiver or operating trustee of any such carrier."

On the date of said order plaintiff was, and ever since has been, a telephone company having annual operating revenues exceeding \$50,000, subject to the provisions of said Act, and a copy of said first issue was sent to plaintiff, and plaintiff has been subject to, and has conformed to, the provisions of said order ever since January 1, 1913.

Said Uniform System of Accounts constitutes a comprehensive regulation of plaintiff's accounts and accounting practices, including the matters of depreciation expense and amortization of capital, two of the accounting matters attempted to be regulated by the order of the said Board herein complained of. The various accounts, in relation to said matters, are defined and designated by number and name, including Account No. 608, "Depreciation of Plant and Equipment," an operating expense account, Account No. 310, "Amortization of Landed Capital," and Account No. 102, "Reserve for Accrued Depreciation," referred to in said order of defendant board. Regulations are made covering the entries to be made in connection with fixed capital withdrawn or retired. Extraordinary repairs, as distinguished from ordinary repairs, are defined and their treatment in relation to depreciation accounting is regulated. The elements that comprise "Expense of Depreciation" are enumerated, including losses from wear and tear, obsolescence, inadequacy, supersession by reason of new invention and discoveries, changes in popular demand or public requirements, and extraordinary casualties. It is provided that the depreciation expense shall be computed upon the cost of the depreciable property, less the estimated salvage, and shall be based upon the estimated average life of the units comprised in the [fol. 12] several classes of property and shall be so charged as to distribute the amount of such cost, less salvage, as nearly as may be evenly throughout the life of the property. The accounting companies are directed to base their depreciation expense charges, according to the foregoing criteria, upon rules to be determined by themselves, but it is provided that these rules shall be derived from

a consideration of the company's history and experience, and the company is required to be prepared at all times to justify the charges as made for depreciation expense by furnishing to the Commission, upon its demand, a sworn statement of the facts, expert opinions and estimates upon which they are based.

Plaintiff avers, therefore, that the entire matter of depreciation expense accounting in all respects has been and is being regulated comprehensively and in detail by said orders, rules and regulations of the Interstate Commerce Commission.

XVII. By Act of Congress, (the Transportation Act), approved February 28, 1920, effective at once, Congress amended paragraph 5 of Section 20 of the Interstate Commerce Act so as to read as follows, (the amending portion of the paragraph being indicated here by italics):

"Interstate Commerce Act—Paragraph (5) of Sect. 20

"The Commission may, in its discretion, prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to the provisions of this Act, including the accounts, records and memoranda of the movement of traffic, as well as of the receipts and expenditures of moneys. *The Commission shall, as soon as practicable, prescribe, for carriers subject to this Act, the classes of property for which depreciation charges may properly be included under operating expenses, and the percentages of depreciation which shall be charged with respect to each such classes of property, classifying the carriers as it may deem proper for this purpose. The Commission may, when it deems necessary, modify the classes and percentages so prescribed. The carriers subject to this Act shall not charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the Commission. No such carrier shall, in any case include in any form under its operating or other expenses any depreciation or other charge or expenditure included elsewhere as a depreciation charge or otherwise under its operating or other expenses. * * ** and it shall be unlawful for such carriers to keep any other accounts, records or memoranda than those prescribed or approved by the Commission. * * *"

On March 18, 1920, the Interstate Commerce Commission issued the following order which was duly served upon plaintiff:

"Interstate Commerce Commission, Washington

March 18, 1920.

"To all carriers concerned:

"Section 435 of the Transportation Act, 1920, contains the following provision:

"The Commission shall, as soon as practicable, prescribe, for carriers subject to this Act, the classes of property for which depreciation

charges may properly be included under operating expenses, and the percentages of depreciation which shall be charged with respect to each such classes of property, classifying the carriers as it may deem [fol. 13] proper for this purpose. The Commission may, when it deems necessary, modify the classes and percentages so prescribed. The carriers subject to this act shall not charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the Commission. No such carrier shall in any case include in any form under its operating or other expenses any depreciation or other expenditure included elsewhere as a depreciation charge or otherwise under its operating or other expenses.'

"Information received by the Commission indicates the existence of doubt as to the propriety of carriers making any charges to operating expenses with respect to depreciation prior to such time as the Commission shall prescribe the specific percentage of depreciation which shall be charged.

"The purpose of this circular is to dispel any such doubts as may exist in the minds of accounting officers.

"Until the Commission shall otherwise order, all carriers subject to the Act to regulate commerce should continue to observe the requirements respecting the accounting for depreciation which are embodied in the effective accounting classification prescribed by the Commission for the respective classes of carriers.

George B. McGinty, Secretary."

Pursuant to the said amendment to Paragraph 5 of Section 20 of said Act the Interstate Commerce Commission has been engaged in carrying out the directions thereof, and divers and extended investigations and proceedings have been made and conducted and hearings held, as will be more fully shown to the court in plaintiff's evidence herein, but the Interstate Commerce Commission has not entered any order further regulating said subject subsequent to the said order of March 18, 1920.

XVIII. Plaintiff avers, therefore, that at all times since January 1, 1913, it has been required by law to conform to the said Uniform System of Accounts and has been and is subject to the sole and exclusive jurisdiction of the Interstate Commerce Commission in respect of said matters, and that the United States by the said Acts of Congress, enacted under and pursuant to Section 8 of Article 1 of the Constitution, and by the said orders and regulations of the Interstate Commerce Commission, has occupied and preempted the field of government regulation with respect to all said matters as they pertain to the said business and property of this plaintiff to the exclusion of any jurisdiction or authority of the defendants in the premises.

XIX. Plaintiff, therefore, avers that the provisions of the order herein complained of, fixing the rates per cent to be charged by

plaintiff as expense of depreciation on account of its several classes of property and for amortization of landed capital are void for want of jurisdiction in the defendants over the subject matter and because said provisions are in conflict with the orders of the Interstate Commerce Commission herein referred to and constitute an interference with interstate commerce in contravention of Section 8 of Article 1 of the Constitution of the United States, and are violative of said acts of Congress and said orders of the Interstate Commerce Commission.

Plaintiff further avers that the provisions of the order herein [fol 14] complained of requiring plaintiff to keep its accounts in the manner therein directed and to make the entries therein set forth are void for all the reasons hereinbefore stated.

Plaintiff avers that it cannot comply with the provisions aforesaid of the order complained of without violating the said orders of the Interstate Commerce Commission and thereby incurring the danger of penalties for such violation provided in the Interstate Commerce Act. Unless defendants are enjoined as herein prayed, they will nevertheless take appropriate proceedings to compel plaintiff, its officers and agents to comply therewith, and for penalties for failure to do so, as provided by the laws of the State of New Jersey.

XX. Plaintiff's depreciation accounting was not regulated by any public authority prior to January 1, 1913, and since that date it has been regulated by the orders of the Interstate Commerce Commission as hereinbefore set forth. Plaintiff has made comprehensive annual reports and other reports to the Interstate Commerce Commission as required by law, which said reports have shown plaintiff's financial status and transactions from time to time, the rates being currently charged for depreciation and amortization and the results of the application of those rates, the debits and credits to and the amount of the depreciation reserve from time to time, and all facts pertaining to its business, as required by the said orders and the rules and regulations of the Interstate Commerce Commission, the rates of depreciation expense and for amortization so charged having been at all times substantially accurate and correct and in accordance with the orders, rules, and regulations of the Interstate Commerce Commission, according to its knowledge and belief. The present depreciation reserve shown by plaintiff's accounts and referred to in the order herein complained of is the result of plaintiff's accounting for depreciation in the manner herein stated, and said reserve has been set up according to law and is not excessive.

XXI. Plaintiff's assets, consisting of its said telephone property in the state of New Jersey, constitute assets devoted to the rendition of its telephone service therein, upon the fair value of which plaintiff cannot be lawfully deprived of a fair return by the imposition of inadequate and non-compensatory rates for telephone service, and such fair return constitutes in law the amount of current net earnings after provision is made for all proper current expenses including

the expenses of depreciation and amortization determined by plaintiff in the manner provided in said Uniform System of Accounts and charged as aforesaid.

XXII. The order herein complained of finds and determines that plaintiff is entitled to an annual return at the rate slightly more than $7\frac{1}{2}\%$ upon the value of its property as a fair return. The order finds the value of the entire property in the state to be \$76,500,000 and finds that plaintiff is entitled to earn thereon as the said fair return the sum of approximately \$5,750,000 a year. In order that the rates for telephone service prescribed by said order may theoretically yield this return of \$5,750,000, and may so appear in plaintiff's accounts, the order first fixes the expense of depreciation and amortization at an inadequate amount, thereby increasing the apparatus current net earnings by a corresponding amount, which, however, still leaves the earnings short of the said [fol. 15] sum of \$5,750,000 by approximately the sum of \$1,300,000. To make up this deficiency of earnings in the accounts said order further requires that the charges to expenses for depreciation and amortization shall be further reduced below the already inadequate amounts found and prescribed by the Commission by an amount which will permit the resultant net telephone earnings to be shown on its books as equal to the fair return on the fair value of its property in service as indicated therein, until such time as the sum of \$1,750,000, alleged by said board to be an accumulated excess in the depreciation reserve shall have been absorbed. Plaintiff alleges that these provisions of defendant's order are void because of want of jurisdiction over the subject matter, as already hereinbefore alleged, and because if enforced they would deprive plaintiff of its property without due process of law in disregard of its rights under the Fourteenth Amendment to the Constitution of the United States.

XXIII. Plaintiff alleges that the rates per cent for depreciation expense found and determined by the said order of defendants are substantially less than the true, correct, adequate, and lawful rates, and that if plaintiff is compelled to charge said rates its property will be confiscated in violation of its constitutional rights as aforesaid.

XXIV. The rates for telephone service which said order herein complained of (Exhibit A hereto attached) required plaintiff to continue in effect do not and will not afford the plaintiff a fair return upon the fair and reasonable value at the time of use of its property used or useful in and exclusively devoted to the rendition of its service but are confiscatory in effect; the said order is, therefore, null and void for the reasons hereinbefore alleged. If said order complained of is enforced and plaintiff is compelled to charge the rates therein prescribed and if plaintiff shall practice all reasonable economies consistent with adequate and efficient service to the public the financial results will be as follows: Plaintiff will be prevented from earning any return in excess of 0.40% per annum upon the fair and reasonable value of its said telephone property

in the State of New Jersey used in furnishing intrastate service and from earning any return in excess of 0.46% per annum upon the cost of said property and will be prevented from earning any return in excess of 3.56% per annum upon the fair and reasonable value of its telephone property in the State of New Jersey used in furnishing telephone service, both intrastate and interstate, and from earning any return in excess of 4.12% per annum upon the cost thereof.

XXV. Unless the defendants are restrained and enjoined as herein prayed they will, as plaintiff believes and so alleges, attempt to compel plaintiff to comply with said order dated December 31, 1924, herein complained of and in the event of plaintiff's non-compliance therewith will attempt to enforce the penalties prescribed by the laws of the State of New Jersey and plaintiff, its directors, officers, agents and employees will be deterred and prevented by the threat of said penalties from charging lawful rates and from charging any rates other than those prescribed by said order and thereby plaintiff will be forced to submit to the confiscation of its property without due process of law and in violation of its rights under the [fol. 16] Constitution of the United States as hereinbefore alleged and will be subjected to great and irreparable loss and damage.

XXVI. Unless the defendants are restrained and enjoined as herein prayed plaintiff's subscribers will, as plaintiff believes and so alleges, be induced and caused to resist and refuse payment of any rates for service other than those prescribed and directed to be continued in said order. The present number of plaintiff's accounts with subscribers in the State of New Jersey is more than 259,205 and the present average monthly bill rendered to them on account of exchange service is less than \$3.15. Because of the nature of the business of the plaintiff and the fact that the amounts due monthly from its subscribers for telephone exchange service are generally small it is impracticable for plaintiff to enforce collection thereof by actions at law. Plaintiff has no practical way to enforce collection of its rates and charges except by cutting off and refusing service for default in payment of its bills rendered monthly therefor and its subscribers will, as plaintiff believes and so alleges, institute large numbers of suits in various jurisdictions throughout that part of the State of New Jersey operated by plaintiff to restrain plaintiff from cutting off and denying service for such non-payment of bills and for damages and plaintiff will thereby be subjected to an endless multiplicity of suits. The issues which would be presented in each such suit are presented and should and will be decided in this action.

Plaintiff has no plain, speedy or adequate remedy at law.

Wherefore plaintiff prays:

(1) That the rates for telephone service prescribed and directed to be continued in said order of December 31, 1924, (Exhibit "A" hereto attached), be decreed to be confiscatory, in violation of the Constitution of the United States, and the order imposing same to be void.

(2) That the provisions of said order fixing and prescribing the rates per cent. to be charged by plaintiff for depreciation expense and amortization of capital and the provisions requiring plaintiff to charge for depreciation and amortization of capital amounts that are less than the currently accruing amounts of said items, and the provisions thereof requiring plaintiff to set up on its New Jersey Division ledger separate reserves and to make therein the entries in the amounts stated in said order, be decreed to be confiscatory and in violation of plaintiff's rights under the Fourteenth Amendment to the Constitution of the United States and an interference with interstate commerce in contravention of Section 8 of Article I of the Constitution of the United States and contrary to the provisions of the Interstate Commerce Act as amended and contrary to the orders of the Interstate Commerce Commission, issued pursuant to said Act, and the said order be decreed to be void.

(3) That the defendants and each of them and all other persons be temporarily and permanently restrained and enjoined from any attempt to compel the plaintiff, its officers, agents and employees to observe or keep in force the rates for telephone service prescribed by said orders of December 31, 1924, or any of the other provisions of said order.

(4) That the defendants and each of them and all other persons be temporarily and permanently restrained and enjoined from taking or initiating any steps or proceedings against the plaintiff, its officers, agents or employees to enforce any penalties or any other [fol. 17] remedy for disregarding the rates prescribed by said order or any of the other provisions of said order.

(5) That the defendants and each of them, and all other persons be temporarily and permanently restrained and enjoined from interfering in any way with the said schedules and rates for telephone service made and filed by plaintiff on March 6, 1924, to become effective April 1, 1924, either by initiating and prosecuting proceedings to compel plaintiff to charge any other or different schedule of rates or by the imposition of penalties, or otherwise.

(6) That the plaintiff have such other and further relief as may be just and equitable in the premises.

May it please your Honors to grant unto the plaintiff, not only a writ or writs of injunction both interlocutory and permanent enjoining and restraining the defendants and all other persons as aforesaid, but also a writ of subpoena of the United States issuing out of and under the seal of this Honorable Court, directed to the said defendants, Board of Public Utility Commissioners of the State of New Jersey and Harry V. Osborne, Joseph F. Autenreith and Frederick W. Gnichtel, the persons constituting said Board, commanding them and each of them, on a day certain to be named therein and under a certain penalty, to be and appear before this Honorable Court then and there to answer, but not under oath, answer under oath being hereby expressly waived, all and singular the premises and to per-

puted by the application to the respective ledger balances of fixed capital in the following depreciation percentages:

Account	Annual depreciation rate—%
Exchange Right of Way	5.26
Toll Right of Way	4.55
Buildings	2.67
Central Office Equipment	5.00
Other Equipment at Central Offices	5.38
Station Apparatus	2.95
Station Installations	1.00
Interior Block Wire	4.00
Private Branch Exchange	3.14
Booths and Special Fittings	3.47
Exchange Pole Lines	7.66
" Aerial Cable	4.45
" " Wire	10.50
" U. G. Conduit, Main	1.33
" " " Subs	4.00
" " Cable, Main	1.95
" " " Subs	4.09
" Submarine Cable	4.54
Toll Pole Lines	5.09
Toll Aerial Cable	2.42
[fol. 19] Toll Aerial Wire	3.47
Toll U. G. Conduit	1.33
Toll U. G. Cable	2.17
Toll Submarine Cable	3.73
Office Furniture and Fixtures	5.27
Interest During Construction	4.28
Store Equipment	5.75
Stable and Garage Equipment	15.46
Tools and Implements	13.33

These percentages are stated on an annual basis but may be translated to a monthly basis by proportion.

(d) Beginning with January 1st, 1925, the debits to expenses as provided in (c) foregoing shall be decreased by an amount which will permit the resultant net telephone earnings to equal the fair return on the fair value of its property in service as indicated herein, continued to subsequent dates by the use of book net additions, and the difference shall be charged to expenses and concurrently credited to the proper reserve. When the total deductions from the normally required depreciation expense shall have aggregated a total of \$4,750,000 such deductions shall be no longer made.

(e) The property or assets constituting the depreciation fund, equal in amount to the sum of the two reserves above referred to under (a), shall be used in manner provided by law.

This order shall become effective January first, 1925.

Dated, December 31st, 1924.

Board of Public Utility Commissioners, by (Signed) H. V. Osborne, President. (Seal.)

Attest: (Signed) Alfred N. Barber, Secretary.

I hereby certify the foregoing to be a true copy of an Order adopted by the Board of Public Utility Commissioners at its meeting held Wednesday, December 31st, 1924, and recorded in the minutes of said meeting.

—— ———, Secretary. (Seal.)

A true copy. H. V. Osborne.

[fol. 20] STATE OF NEW JERSEY:

BOARD OF PUBLIC UTILITY COMMISSIONERS

In the Matter of the Schedules Filed by the New York Telephone Company Increasing Rates and Charges for Telephone Service in the State of New Jersey.

Decision

Frankland Briggs, Edward Beattie and Paul H. Burns, for the Petitioner.

Frank H. Sommer, L. Edward Herrmann and Leighton Calkins, for the League of Municipalities.

George L. Record and A. O. Miller for the City of Passaic.

Jerome T. Congleton for the City of Newark.

W. E. Marsden for the Town of Montclair.

Thomas J. Brogan, Stephen M. Egan, Jr., and N. L. Paladean, Jr., for the City of Jersey City.

E. W. Coffin for the Hoboken Chamber of Commerce.

Eugene T. Sharkey for the City of Bayonne.

Thomas H. Haggerty for the City of New Brunswick.

William S. Stuhr for the Township of Weehawken.

David P. Wilentz for the City of Perth Amboy.

Samuel Hirschberg for the Town of West New York.

Thomas P. Fay and Jacob Steinbach, Jr., for the City of Long Branch.

A. M. Agnew for the Borough of Cliffside Park.

J. W. Marini for the Borough of Fairview.

Charles H. Roemer for the City of Paterson.

Whittemore & McLean for the Borough of Linden.

The New York Telephone Company carries on a general telephone business in the northern part of New Jersey as well as New York and western Connecticut. It also owns and controls telephone companies outside of the State of New Jersey, as well as other companies and corporations, the business of which is connected with the telephone industry.

The American Telephone & Telegraph Company owns and controls the stock of the New York Telephone Company and other operating companies throughout the United States which are collec-

ively known as the "Bell System," as well as the Western Electric Company which is engaged in the manufacture and sale of telephone materials and appliances. It also furnishes the service provided for under the "license contracts" (discussed in detail hereinafter) with the associated companies of the Bell System, as well as long distance toll traffic for connecting the service of the Bell System throughout the United States.

On March 6th, 1924, the New York Telephone Company filed with the Board a schedule of rates to become effective April 1st, 1924, which increased the rates then charged by the company for telephone service in the portion of the State in which it operated.

[fol. 21] The Board thereupon, pursuant to the statute (P. L. 1911, Sec. 16, (h)), proceeded to hear and determine whether the said increase is just and reasonable. Pending such hearing and determination the Board ordered the suspension of the proposed increased rates, until October 1st, 1924, as provided by law. The rates were further suspended, by stipulation, until January 1, 1925.

The telephone company alleges that the proposed increase is made for the purpose of enabling it to earn a fair return upon the fair value of its property devoted to the public use in this State.

In 1916 an inquiry was made by the Board as to whether the then existing rates of this company were just and reasonable. At the conclusion of that investigation the Board held that the rates then charged were unjust and unreasonable and directed the company to file a schedule of rates which would effect an annual reduction in net revenues of not less than \$800,000. This order became effective December 31st, 1917. The company filed a petition for a modification of this order which, after hearing and investigation, the Board dismissed.

In a proceeding in 1920, in which the company filed rates to become effective upon the return to it of its property by the United States Government the Board continued the inventories of the property of the company to June 30th, 1919, and found a value of \$34,700,000. The decisions in these cases are reported in P. U. R. of this State, Vol. V, p. 618 and p. 714, and Vol. VIII, p. 545.

During the progress of this case fifty-five witnesses were examined on behalf of the company, five on behalf of the Board, five individuals, and two municipal representatives complaining of service, making a total of sixty-seven witnesses. One hundred and twelve exhibits, containing 2,172 pages, were submitted by the company. Sixty-three exhibits were prepared and submitted by the Board's experts, containing 345 pages; and five exhibits were submitted on behalf of the municipalities or associations. The total exhibits number one hundred and eighty, and the pages upward of 2,500; the testimony amounted to 3,660 pages, making a total of over 6,000 pages.

The length of time consumed from the filing of the rates to the close of the hearings was due in part to the fact that the company did not have its case fully prepared at the time of filing its proposed schedules and in part to the necessity for examination and analysis by the State's experts which resulted in a revision and modification of the company's original figures.

By reason of the suggestions and criticisms of the experts of the Board, the company conceded that its original valuation was excessive and reduced its claim by upwards of \$6,000,000, the effect of which reduction being to reduce the amount to which it claimed to be entitled to receive \$400,000 to \$450,000.

In the determination of this case the Board has considered the value of the property of the New York Telephone Company located in the State of New Jersey as well as property of said company situated without the State used by the company in the rendition of service to the company's customers in the State of New Jersey; in the final determination, however, this foreign property is excluded from the rate base and an appropriate amount added to expenses (rent deductions, etc.).

While it appears that no increase in rates is found to be justified at this time for the reasons hereinafter indicated, it is apparent that when the excess in the depreciation reserve has been absorbed the [fol. 22] rates may have to be readjusted. The Board has therefore determined questions of value, depreciation, etc., in order to avoid a duplication of expense, if and when it becomes necessary to consider the question of rates in the future.

Values of Fixed Capital

I. Tangible Fixed Capital—Value of Plant and Property in Service

1. Book Value.—On behalf of the company, Exhibit P-96 was submitted, showing that the book value of the property as of June 30th, 1924, for the New Jersey Division, was \$73,879,877.76, which included intangible capital of \$522,135 (going concern items), plant and equipment in service of \$70,994,265, and construction in progress of \$2,363,478 (unfinished plant bearing interest during construction). This will be shown in Appendix I. It is to be borne in mind that these figures are the book cost new without reference to depreciation which has accrued therein. This will be shown later in a condensed form in Table I of this decision. The testimony of Mr. Hill (Exhibit C-3, table 21) and Mr. Petty (Exhibit C-21) indicates that about five-eighths of the property has been installed at unit costs prevailing December 31, 1923, since which time certain unit costs have materially declined. This would indicate that an even larger percentage has been installed at the lower unit prices prevailing July 1st, 1924. In the first six months of 1924 about \$1,000,000 of the property, presumably that more subject to appreciation, has been retired. Both of these elements tend to bring the book costs more nearly in line with present day costs. This indicates that great weight should be given to these book costs.

2. Company's Appraisal.—Through Mr. George W. Whittimore, its appraisal engineer, the company submitted an inventory and appraisal of the property in its New Jersey Division as of the date of December 31st, 1923, summarized in Exhibit P-29. This inventory included all the property of the company, tangible and intangible, fixed capital or plant in service and construction in progress (plant not in service but bearing interest during construction) and working capital. As shown in Appendix II, the total value claimed

under this inventory and appraisal as of that date aggregates \$8,833,213 (which included construction in progress to completion included). This valuation is based on the so-called "reproduction" theory, which has been approved by the courts, and which, the courts hold, must be given great weight in determining present day value. And this notwithstanding the fact that there are but few known instances of such actual reproduction. In applying this method is the recognized practice to evaluate the property of the utility and useful in the service of the public on the theory that you start with nothing and develop the property to completion at prices that reflect, as nearly as possible, present day unit costs, and generally includes, as in this case, every possible element and contingency entering into the cost of the theoretically reproduced property. This original appraisal was the result of the work of a large force of experts working for many months and is set forth in detail in Exhibits P-21 to P-29, inclusive, and in Exhibit P-44. The unit prices applied to the elements of property included in the inventory afore-said were those prevailing as of December 31st, 1923, based largely upon the company's costs of doing work during the year 1923. The completed appraisal included not only finished plant and equipment in service, but also construction in progress and New York property (fol. 23) devoted to the service of the New Jersey Division. Over-heads of 1.77 per cent. or \$173,844 were added to land (but excluded by State's experts).

3. Revision of Company's Appraisal.—A detailed examination of this voluminous inventory and appraisal by the Board's experts disclosed a number of items subject to criticism and due to these criticisms Mr. Whittemore, for the company, submitted a revised summary of value, as of June 30th, 1924, with his structural overheads modified so as to make them consistent with those based on the company's accounts. A condensed summary of this valuation will be found in Appendix II.

Appendix IV begins with the original appraised total value of \$8,833,213 and indicates the changes in set-up, the deductions and additions made by the witness in the six months' interval ended November 7th, 1924, when his final exhibit was introduced.

The changes made in the original appraisal, due to criticisms or price changes are as follows (see Appendix IV):

Deductions for errors.....	\$629,729	
Deductions for overhead charges	3,445,511	
Subtotal		\$4,075,240
Deductions owing to central office equipment price changes		1,612,728
Subtotal		\$5,687,968
Construction in progress omitted later (book figure)...		2,997,354
Total deductions.....		\$8,685,322

The first subtotal is subject to depreciation deduction of about one-seventh.

With respect to construction in progress, while the witness excluded this item in his final value as a rate base, he asked that 2 per cent. of the amount of same be allowed, in addition to 8 per cent. on the value of \$90,467,437 which excludes the deduction of "manifested inadequacy," of \$2,071,794 (Exhibit P-99—1 B).

The company claims it is entitled to 8 per cent. return on the value of its property. The company's estimate does not indicate that the proposed rates will produce 8 per cent. on the value claimed by them (Exhibit P-99, fair return for 1924 claimed, \$7,281,204), but if the high value had been established without contest or investigation, there would be nothing to prevent the company from asking for still higher rates. The cost of establishing this lower value will be repaid manifold each year by the proved reductions.

The final value as of June 30th, 1924 had adjusted net additions of \$5,948,357 (Exhibit P-99, p. 6) not made or shown in the original valuation.

4. Appraisal for the State, Made by J. G. Wray & Co.—The Board employed Messrs. J. G. Wray & Company, expert telephone engineers, to examine, analyze and criticize the inventory and appraisal submitted on behalf of the company. To check the inventory a field force was employed to list a specified percentage of outside plant and to examine the central offices of the applicant (Exhibits C-10 to C-15, inclusive). The results of this examination showed various errors in the inventory and appraisal as originally submitted. The major items criticized in the company's setup was with respect to the unit prices used, Mr. Whittemore's prices being based largely on the unit costs of work done by the company during the year 1923. This work involved some major construction, but a very [fol. 24] large amount was of small or piecemeal construction, entailing large unit costs. Mr. George W. Cummings, of the staff of Messrs. J. G. Wray & Company, submitted Exhibit C-26, entitled "Estimated Cost of Reproduction on Basis of Wholesale Construction." This included not only plant in service, but also construction in progress, which represents plant not yet in service, carrying costs taken care of by a charge to capital account of interest during construction. This exhibit indicated that, on the basis of wholesale construction, the company's estimated cost of \$88,478,957 would, if unit prices for wholesale construction were employed, result in a reduction of \$6,219,953 or a decrease to \$82,259,004. These latter figures are exclusive of the Farmers Division, involving, under Mr. Whittemore's appraisal, \$354,257, reduced under a wholesale construction program to \$310,464, a decrease of \$43,793. As in Mr. Whittemore's appraisal, each class of property included construction in progress and the totals also included the estimated value of New York property devoted to the service of the New Jersey Division.

On pages 2212 to 2217 of the testimony, Mr. Cummings gives his method of arriving at the wholesale cost of construction involved in reconstructing the applicant's property in five years or less. The

company's witness based his unit costs largely on unit prices for work done in 1923 under conditions which involved much more piecemeal construction and consequent loss of time (for which he made only partial allowance) than efficiency would require under the reproduction new theory. If the company were reconstructing its property, for instance, (testimony, p. 2104, 2118) the workmen would go from house to house in an orderly manner and without waste of time, whereas under piecemeal construction a workman may be called upon to install instruments at widely separated locations, being in transit a large percentage of the time necessary to install an instrument. And so throughout. Mr. Cummings eliminates this time in Exhibit C-26 and following exhibits based thereon. The Board gives considerable weight to this estimate in connection with the reconstruction cost theory, as being based on reasonable assumptions in the premises.

Mr. Cummings did not submit in exhibit form a final summary comparable to that submitted by Mr. Whittemore, shown in Appendix II, but the elements for making that summary are in the record and are recapitulated in Appendix IV attached to this decision, and will be abstracted in Table I which is given hereafter and are shown in Appendix III.

5. 1916 Appraisal Continued and Appreciated.—Mr. John P. Petty, the Board's Deputy Chief Engineer, submitted a valuation based on the value of 1916 as fixed by the Board in its decision of November 20th, 1917 (Vol. V, p. 618, et seq.). This valuation was continued by the application of the construction cost indices based on the company's unit costs from year to year and applied to adjusted structural values as fixed by the Board in 1916 and to the adjusted net additions as of December 31st, 1923 (Exhibit C-17 to C-21, inclusive). These cost indices translate the cost of the property from year to year at the unit prices assumed or actually paid into the costs prevailing as of December 31st, 1923 and were summarized in Exhibit P-22 as of December 31st, 1923. In other words, the 1916 value, as found by the Board and acquiesced in by the company, with additions to date, is appreciated to date. In his computations [Vol. 25] Mr. Petty deducted the increase in the reserve for accrued depreciation since June 30th, 1916 to December 31st, 1923 and also included New York property devoted to the service of New Jersey. He deducted this increase in the reserve for the reason that it had been invested in the property and to that extent the company was not required to contribute the capital necessary to finance these additions. In Appendix V, Exhibit C-22 is condensed and continued to June 30th, 1924 and price changes of central office equipment are taken into account and accrued depreciation based on inspection is deducted in composite percentages corresponding to those used in Messrs. J. G. Wray & Company's final summary in Appendix III. The results of this continuation are set forth in condensed form in Appendix III and in Table I hereinbefore referred to.

Construction in Progress.—In the original appraisal submitted to the Board by the company, each class of property not only in-

cluded completed plant in service but also construction in progress not yet used in rendering service. The same overheads were added to construction in progress as to completed plant, except in case of buildings and central office equipment. The interest during construction would take care of return on this construction in progress under the normal operations of the company and to include the base cost plus this interest during construction charged as a capital expenditure in the fair value, would entail a duplication of 7 or 8 per cent. per annum thereon. Moreover, in fixing the fair value as of June 30th, 1924, the mid-point of the year, and taken as the average for the year, nearly \$6,000,000 of net additions from January 1st to June 30th, 1924 are included. In order to make the value so taken an average for the year, the company must add in the second half of the year net additions of nearly \$6,000,000, an amount more than twice the construction in progress at June 30th, 1924.

The Board therefore excludes from the fair value of the property used and useful in rendering the service, construction in progress which is not rendering service but which bears a charge to capital account of interest during construction until the property is placed in service.

In the company's final exhibit setting forth its claim for the amount of revenue to which it is entitled, while construction in progress was excluded from the base, a charge of 2 per cent. per annum is added to the amount of construction in progress as of June 30th, 1924.

The Board finds no warrant for the addition of this 2 per cent. for property not yet used and useful which bears interest during construction until it is placed in service.

It will be noted from the foregoing discussion that the basis for the fixation of value as originally presented has shifted during the course of the proceedings by the modification of appraisals as originally submitted, and that the unit prices and structural overheads have been decreased to make the appraisal conform to the accounting practices of the company. The pertinent indicia of value are brought together in the following table, which also includes preliminary costs and going concern value, working capital and construction in progress, discussed hereinafter in more detail. These summaries do not include any element of value for New York property devoted to the service of the New Jersey Division, this property being taken care of by a charge to operating expenses on the basis of substantially ten per cent. on the value thereof to take care of return on value, depreciation, maintenance, etc.

Tangible fixed capital

	Book costs, fixed capital & construction in progress	Company's reproduction cost new and depreciated	Wray's reproduction cost new and depreciated	Petty's 1916 valuation, cont'd, appreciated and depreciated
	Ref. Appendix I (1)	Ref. Appendix II (2)	Ref. Appendix II (3)	Ref. Appendix II as in col. (3) Ref. III (4)
a. Cost New 7/1/24	\$70,994,265	\$86,052,714	\$82,970,417	\$80,945,736
b. Less Existing Deterioration	8,199,837 (1)	9,939,177	9,286,980	9,057,828
c. Cost New less Existing Deterioration	\$62,794,428 (1)	\$76,113,537	\$73,683,437	\$71,887,908
d. Less Manifested Inadequacy	1,710,963 (1)	2,071,794	2,149,764	2,080,305
e. Tangible Fixed Capital Depreciated	\$61,083,465 (1)	\$74,041,743	\$71,533,673	\$69,807,603
f. Intangible Capital (or going concern value) ..	522,135	11,782,000	3,446,843 (2)	3,600,000
g. Total Fixed Capital, less depreciation	\$61,605,600 (1)	\$85,823,743	\$74,980,516	\$73,407,603
h. Working Capital	2,571,900 (1)	2,571,900	1,770,000	1,770,000
i. Depreciated Cost or Value of Property in Use ..	\$64,177,500 (1)	\$88,395,643	\$76,750,516	\$75,177,603
j. Property Not Yet Used .....	.....	.....	.....	.....
k. Construction in Progress	2,363,478	2,190,425	2,363,478	2,363,478
l. Grand Total—All Property	\$66,540,978 (1)	\$90,586,068	\$79,113,994	\$77,541,081

NOTE.—In the Board's opinion the figures in line "i" are to be considered in arriving at a rate base.

(1) Not a book figure; for comparison the percentage of depreciation shown in column (2) and also working capital are used in column (1). (2) Exhibit C-53.

In column (1) the book cost of the tangible fixed capital in service is shown to be \$70,994,265. The percentages applied to this figure in order to arrive at the existing deterioration and manifest inadequacy thereof are based on the percentages shown in Mr. Whittemore's final summary of appraisal shown in the second column of Table I. This results in a cost new less observed depreciation amounting to \$61,083,455.

Column (2) sets forth in condensed form Mr. Whittemore's final estimate of cost to reproduce the tangible fixed capital of plant in service, both new and less adjusted deterioration and manifest inadequacy. His reproduction cost new as of June 30th, 1924 amounts to \$86,052,714 and the same costs less observed depreciation amount to \$74,041,743. Messrs. J. G. Wray & Company's final figure on the same basis, but on the assumption that the property will be constructed as a whole, shows a reproduction cost new of \$82,970,417 and, less existing deterioration and manifest inadequacy, of \$71,533,673. Mr. Petty's appraisal of 1916, continued to June 30th, 1924 and reflecting July 1st reduction in central office unit costs, aggregates a total of \$80,945,736 and deducting the existing deterioration and manifest inadequacy in the percentages adopted by Messrs. J. G. Wray & Company, shows a reproduction cost new less depreciation of \$69,807,603 (Appendix V).

The company's brief criticizes Mr. Petty's "built up value." The Board is of the opinion that this criticism is not justified as Mr. Petty's figures are based on the Board's finding of value in 1916, in which was considered a formal appraisal submitted by the company, and on gross additions since that date; retirements are estimated to have taken place at a uniform rate (an assumption which tends to increase the aggregate value finally found) and to the prices for each year are applied for the various classes of property cost indices based directly on the actual costs which have been incurred by the company since that time and by this method all costs are brought down in Exhibit C-22 to the price level of December 31st, 1923.

In Appendix V the figures are continued to June 30th, 1924, and reflect the subsequent adjustment in prices effective as of that date. This is not the ordinarily so-called "split inventory" or "built up method" but reflects very closely the actual costs of the company and the actual overheads revealed in its books of account translated into its own 1924 prices.

Line "i" of Table I shows the four figures constituting the indicia of value of tangible fixed capital considered by the Board. The highest figure for reproduction cost new less observed depreciation is Mr. Whittemore's figure of \$74,041,743, after deducting manifest inadequacy; he expressed the opinion that the latter should not be deducted as it is provided for by a very adequate depreciation reserve; the Board is of the opinion that it should be deducted in view of the fact that it is not only observed but its retirement is provided for and especially as the fund for its retirement is obtained from the rate payers. On the same inventory and on the basis of reproducing the property with the greatest efficiency, Messrs. J. G.

Wray & Company's estimate of reproduction cost new, less observed depreciation, is \$71,533,673. Mr. Petty's figure, derived from the 1916 appraisal continued by book costs to June 30th, 1924, all appreciated to reflect prices prevailing July 1st, 1924, and depreciated in the same measure as shown in column (3) results in a final estimate of value of \$69,807,603. The book figure depreciated in accordance with Mr. Whittemore's percentages leads to a book cost, less observed depreciation, of \$51,083,465. While Mr. Whittemore's figure of \$74,041,743 is based on a construction program of five years (which should necessarily be on a wholesale basis for unit prices) the unit prices used by him in many instances are based on the experience of the company in 1923, when a large amount of small, or piecemeal, construction was done, including overheads on land. Even though some allowance may have been made for a portion of the higher unit costs due to such piecemeal construction, the Board is of the opinion that his maximum figure is too high.

In view of all the testimony and exhibits as summarized above, and in the exercise of that judgment imposed upon it by law (*Smythe v. Ames*, 169 U. S. 465) the Board finds and determines that the fair value of the tangible fixed capital of physical plant and equipment in service, including rights of way and less accrued depreciation, as of June 30th, 1924, is \$71,000,000.

II. Intangible Value (Preliminary Cost and Going Concern Value)

The company's claim for preliminary cost and going concern value is set forth in detail in Exhibit P-14 and summarized on page 4 of that exhibit. The amount claimed is \$11,782,000. This figure is arrived at by the so-called "comparative plant method," in which is estimated a given construction period (five years assumed in this case), a given time at which the various units of property go into service, the carrying cost of such property during the assumed development period, and the operating expenses, decreased by the revenue to be derived during the assumed development period. The difference between the carrying costs, increased by the operating expenses and decreased by the revenue received during said development period, is taken to represent a preliminary cost and going value of the property. As computed by Mr. Whittemore, on his assumptions, these amounts aggregate \$11,782,000. If it be that the company is particularly successful and that the development period of years is short, this method will produce a smaller going value than if the company is assumed to be less successful at the start and completes the plant and attaches the business less rapidly. It would, therefore, produce a larger going concern value or development cost for the less successful than for the more successful company. This result is the opposite of what it should be. That this method lacks evidential value is clearly demonstrated by the exhibits of Mr. Wray, who stated that, in his opinion, instead of requiring five years to install the plant and property of the company, it could reasonably be done in four years and in Exhibits C-52 to C-58, inclusive, he showed that, by a few reasonable modifications in

assumption, the going concern value could be fairly represented, under these various assumptions, by figures varying from \$3,446,843 (Exhibit C-53) up to the figure of \$11,782,000 upon the assumptions made by Mr. Whittemore. The method used by Mr. Whittemore merely reflects his opinion and is based on assumptions made by him. A method which leads to such uncertain results is neither conclusive in its results nor is it very helpful to the Board (Kennebeck Water Dist. v. Waterville, 54 Atl. 6). In the final analysis the ascertainment of intangible values is not possible by any rule or formula, but must be determined by the exercise of ordinary business judgment. From all the facts submitted in the case, and exercising what it believes to be sound business judgment, the Board finds and determines that all intangible elements of value in this plant and property, as of June 30th, 1924, are fairly represented by \$3,600,000.

Accrued Depreciation in Plant and Property

Webster defines depreciation as the "act or state of lessening the worth of." The Century Dictionary says that it is a "fall in value; reduction of worth." Relating to an inventory and appraisal, such as that before the Board, it indicates a reduction of worth expressed in dollars due to any deterioration in the physical plant arising from the following causes:

1. Physical Depreciation.
 - (a) Wear and tear.
 - (b) Age or physical decay.
 - (c) Deferred maintenance (including extraordinary repairs), if any.
2. Functional Depreciation.
 - (d) Inadequacy.
 - (e) Obsolescence.

Accrued depreciation, as herein treated, is the lessening worth in value of the plant and property of a utility due to any or all of the above mentioned causes. Two general methods are frequently used to determine the extent of this accrued depreciation in a given property:

First, by the use of life tables and the age of the various classes of property involved. This is usually called the "theoretical depreciation."

Second, by an actual inspection of the physical property, together with presently foreseeable future retirements from inadequacy and obsolescence. The courts lean strongly toward the latter method as the proper basis for determining the proper amount of depreciation to be deducted from the value new of a utility's property.

[fol. 29] The company's expert divides accrued depreciation into two classes, first, what he terms "existing deterioration," which is more nearly related to the wear and tear or physical decay as shown in the captions (a), (b) and (c) above, and, second, manifested in-

adequacy which is related more nearly to items (d) and (e) above enumerated. In his Exhibit P-99, and his testimony relating thereto, however, Mr. Whittemore does not deduct "manifested inadequacy" in the amount of \$2,071,794, which he finds actually to exist in the plant and equipment in service as of July 1st, 1924, (which plant and equipment in service was valued by him at the same date at \$86,730,123, the percentage relation of "manifested inadequacy" being 2.39 per cent of the latter figure). This "manifested inadequacy" represents very largely his estimate (Exhibit P-28) of the obsolescent central office buildings and equipment, which will probably be removed from service and retired within the ensuing two years ending December 31st, 1926. Testimony in the case indicates that the company has on hand in its depreciation reserve (invested mainly in property and plant) more than a sufficient amount to write off the value of the "manifested inadequacy" in this property if and when retired. Yet both the witness and the company's counsel claim that this deduction from value should not be made when arriving at a rate base. It is claimed (company's brief, page 33) that there is practically no obsolescence in the company's plant. The Board understands from the company's evidence that the manually operated switchboards are becoming obsolete and that this alone is justification for the company's installation of the more expensive type of machine switching apparatus in place of switchboards which mechanically are in good physical and operating condition, and that the "manifested inadequacy" largely reflects this imminent retirement for which a reserve has been created by charges to expenses and set aside to provide for just such retirements. Moreover, in Exhibit P-29, page 2, "Manifested Inadequacy" is classified by Mr. Whittemore under the head of "Existing Depreciation," covering manifest inadequacy, thus recognizing that "manifest inadequacy" is existing depreciation. The decisions hold that existing depreciation shall be deducted from value new.

The Board is of the opinion that the amount of "manifest inadequacy" as found by the Company's witness should be deducted from the value of its property and that it is as clearly deductible as the "existing deterioration," certainly as much so, as the amount thereof can be ascertained with more certainty. It will, therefore, in all set-ups of value deduct both "existing deterioration" and "manifested inadequacy" based largely on Mr. Whittemore's evidence of the percentage condition of the property and other relevant data. The amount of the deductions are shown in Table I herein. Annual depreciation, reserve for depreciation and reserve for amortization of intangible capital (for retiring rights of way) will be considered later herein.

Working Capital

Two estimates of working capital have been presented: one made by the company, shown in Exhibit P-27, as \$2,064,933, as of December 31st, 1923, increased to \$2,571,900 (Exhibit P-99, sheet 1-A) as of July 1st, 1924; the other made by Mr. Hill, shown in Exhibit

C-25, as \$1,253,881, as of December 31st, 1923. The company takes [fol 30] issue with Mr. Hill's determination of working capital on two points only.

1. Estimated required working cash.
2. Treatment of the licensee payment to the American Telephone & Telegraph Company.

1. Working Cash

The actual average monthly cash balance for the New York Telephone Company is about \$5,000,000. Mr. Hill deducted \$3,000,000 from this cash balance on the ground that an average monthly cash balance of \$2,000,000, with a minimum balance as disclosed by the last three years' experience of \$1,000,000, would be sufficient for the conduct of the company's business. No criticism was made by Mr. Hill of the company's policy of maintaining actual cash balances of \$5,000,000, the thought being that the difference between the \$2,000,000 balance required for operations, and the actual average cash balance represents the accumulation of revenues, which will later be paid out as dividends, the accumulation of cash represented by the depreciation reserve before its utilization for plant extensions and betterments, and similar items. These cash balances which are in excess of requirements for operation of the property are not, according to Mr. Hill's view, properly to be included in the rate base on which the company claims a return (testimony, page 2489).

Mr. Sylvan, testifying for the company, stated that such cash balances as are now carried are necessary and cannot be reduced. (testimony, page 2701). He further stated, however, in response to a question as to what is the minimum balance which the banks require, that "as a rule no bank will perform the service, any commercial service of our size, with a balance less than \$2,000 a month, paying interest on daily balances" (Testimony, page 2708). "\$2,000 is the minimum." The New York Telephone Company deals with thirty-two banks in the State of New Jersey (testimony, page 2703). Of these banks, about ten per cent extend commercial and collection service. This service is limited to the smaller districts, no such service being rendered in the large business centers such as Newark, Paterson, Passaic, Jersey City, New Brunswick, Perth Amboy, and similar places (testimony, page 2708).

The company's checks for payrolls and bills are drawn against the National Bank of Commerce in New York City, in which its monthly deposits amount to about \$33,950,000, and the average daily balance is \$1,462,000 (testimony, page 2702).

If the average balance in New Jersey banks be taken as twice the minimum of \$2,000 testified to by Mr. Sylvan, an average balance of \$4,000 per bank in thirty-two banks amounts to \$128,000. Of the average daily balance of \$1,462,000 carried by the company in the National Bank of Commerce to meet payrolls and other large payments, 14.68 per cent is apportionable to New Jersey on the com-

pany's basis of apportionment, (Exhibit P-27, p. 12). This amounts to \$214,600, which, added to \$128,000 balance in New Jersey banks, makes a total average balance of approximately \$340,000. The working cash, estimated in this way from figures given by Mr. Sylvan checks reasonably well with Mr. Hill's figure of \$300,000 for working cash for the New Jersey Division, (Exhibit C-25, Table N. J. 152).

The company does not claim that the actual amount of cash carried in the bank should all be assigned to working capital and included in the rate base. In its Exhibit P-27, page 12, the average actual cash balances for the years 1921, 1922 and 1923 have been [fol. 31] reduced because, as is there stated, the cash balances during parts of those years were unusually large due to additional financing by the company. It appears proper that this reduction of bank balances, which are the basis for working cash, should be carried further, and that the working capital estimate should include only the minimum cash balances required by the banks or on which the company might reasonably be expected to carry on its business. Cash for purposes of new construction, as testified by Mr. Sylvan (testimony, page 2714) is obtained from the American Telephone & Telegraph Company, as and when it is needed, and the financing of new construction would, therefore, have little effect on the company's working capital.

2. Payment to the American Telephone & Telegraph Company under the License Contract as Affecting Working Capital.

In his computation of working capital, Exhibit C-25, Table N. J. 151-b, Mr. Hill has considered the licensee revenue debtor, to be an expense paid in the second month following the rendering of the service which it covers. This treatment, according to the company's witnesses, is not in accordance with the facts, the licensee payment being actually made on the tenth of the month for the current month's services (testimony, page 2712). The matter appears to be one of interpretation of the company's contract with the American Telephone & Telegraph Company, since the current month's payment is computed at 4.5 per cent of the company's revenues in the second month preceding. Assuming the company's interpretation to be correct, Mr. Hill testified that the working capital given in Exhibit C-25 would be increased by approximately \$130,000 (testimony, page 2491). The working capital, as shown in Exhibit C-25, should, therefore, be increased by that amount.

Mr. Hill's Exhibit C-25, as before stated, shows the working capital for the New Jersey Division to be \$1,253,881 as of December 31st, 1923. After making the correction for the licensee revenue payments as indicated above, the working capital as of the same date becomes \$1,406,714. As the company had at the same date 276,460 telephone stations in service, the average working capital per station was therefore \$5.09. As no new computation has been made it may be assumed that the cost per station as of June 30th, 1924, will not have varied, and, related to the number

of stations in service as of that date (347,554), the working capital would amount to \$1,739,050. Although above assumed, it does not follow that the working capital increases at the same rate per station.

Working capital, as herein found, is an element of the rate base upon which the company is entitled to earn, the "fair return" allowed by law. It therefore becomes the duty of the Board to determine the amount thereof, and in the light of all the testimony adduced the Board finds that \$1,770,000 will provide the company with adequate working capital.

Recapitulation of Values as Found by the Board as of June 30th, 1924

Tangible Fixed Capital less depreciation—Plant in Service	\$71,000,000
Intangible Fixed Capital (Going Concern and Preliminary Costs)	3,600,000
Total Fixed Capital Depreciated	\$74,600,000
Working Capital	1,770,000
✓ Total	\$76,370,000

[fol. 32] In the light of all the testimony and exhibits, the Board fixes the fair value of the property of the New York Telephone

Company on which it is entitled to a fair return at \$76,370,000, as of June 30th, 1924.

Rate of Return

The company submitted testimony and exhibits from two witnesses with respect to yields of utility securities at market prices and with respect to the rate of return.

The first witness was Mr. William H. Blood, of Stone & Webster. On June 11th, 1924 (page 893 of the testimony) he stated that the yield on good first mortgage public utility bonds during recent months was at market prices from 6 to 6.5 per cent., which yield should be increased somewhat to take care of banker's commission; that the lowest yield considered by him was 5.95 per cent, and the highest 6.6 per cent. In his view, the yield to the investor on utility preferred stock would range from 7 to 8.5 per cent where the actual dividend rates ranged from 6 to 8 per cent on the par value of the stock. On common stock the yields would run from 7.5 to 9 per cent or a little over, and that 8 per cent would constitute a fair average rate.

He stated that no telephone securities were considered in the list of companies from which he formed his conclusions (page 895). On page 896 of the testimony appears the following:

"Q. Would not an authority like Moody give a better reflection of the market or as good as you could give? * * * A. Probably a good deal better."

Mr. Halbert P. Gillette, in Exhibit P-41, "Average Yield of Securities," set forth the yields of public utility bonds for the years 1903 to the first quarter of 1924; that yield in 1903 was 4.63 per cent and the yield in the first quarter of 1924, 6.31 per cent. The note attached to this exhibit states:

"NOTE.—Those yields are taken from Moody's 'Public Utility Investments' which says: 'The following averages of the prices of capital are based upon a large number of new issues made during the respective periods, the data used being the net yields to investors.'"

"If the average brokerage fee of 3% is paid by the company on 20-year bonds, the cost of money to the company will be 0.1% added to the above yields. Thus, for Public Utility Bonds during the first quarter of 1924, the yield to the investor averaged 6.31% to which would be added 0.1% making 6.41 per cent average cost of money to the average utility company."

(See also testimony, pages 801 and 802.)

In the 1923 edition of Moody's "Public Utility Investments" a table similar to that quoted in Exhibit P-41 is also shown and the following comment was given in explanation of the higher average price of capital to utilities in said list:

"The rise in the price of public utility capital was due mostly to the unfortunate situation of electric railways consequent on the failure of street car fares to keep pace with the advance in operating costs."

The Board is dealing with telephone properties. The average price of capital which includes the high cost of street railway capital would be reduced if the securities of street railway companies were eliminated from those included in Exhibit P-41.

[fol. 33] Mr. Gillette also submitted Exhibit P-42, a list, of some twenty-two light and power companies' securities (no telephone companies included) which showed the following market yields on the average:

Bonds	6.26 per cent.
Preferred Stock	7.52 per cent.
Common Stock	7.21 per cent.

If these yields be applied to the bonds and stocks of the New York Telephone Company in the percentage amount outstanding, as of December 31st, 1923, the composite yield would be 6.92 per cent, at the market, adding to which the 0.1 per cent. for financing would bring the yield on the basis of Mr. Gillette's testimony to 7.02 per cent. It is to be noted, however, as pointed out later by Mr. Petty

in his testimony, that the class of securities included in this list were of a lower grade than those of the applicant and therefore would require a higher return to attract capital.

Mr. Petty submitted a number of exhibits showing the yields of telephone securities for the applicant, based on historical studies, and of other telephone and telegraph companies. These exhibits are the only ones relating to market yields to telephone securities, which have been introduced in the case.

Mr. Petty has, for a number of years, studied the market values of security issues and yields in connection with his duties as Deputy Chief Engineer of the Board.

In Exhibit C-38, Mr. Petty sets forth in tabular form an exhibit entitled "Average Monthly Prices of Five Telephone and Telegraph Bonds, January 1914 to August 1924, Inclusive, as Computed by Moody's Investors Service." In Exhibit C-39, the average monthly yields of the same five telephone and telegraph bonds at prices shown in Exhibit C-38 were set forth. This exhibit was put in graphic form in Exhibit C-40 and the bonds included are described thereon. The average monthly yield for the ten years ending December, 31, 1923 on these five bonds was 5.53 per cent. of the market price. During the first eight months of the year 1924 the average yield was 5.27 per cent. and the yield in June and July, respectively, was 5.18 and 5.14 per cent.

In Exhibit C-41 Mr. Petty submitted a graph entitled "Composite Yields of Major Issues of the New York Telephone Company's Bonds at Average Market Prices thereof, 1914-1924" based on data prepared by himself. This showed that the average yield at the market price to the investor during this ten year period was 5.44 per cent. or nine points lower than the yields of the five telephone and telegraph bonds set forth in Exhibit C-40 above referred to. The yield in June, 1924, the last figure shown on the graph, was 5.19 per cent. on the average market price for that month. This average yield is sufficient to induce investment in the company's bonds.

The New York Telephone Company's bonds, as hereinbefore indicated, are of a higher grade than those quoted by the company's witness and are strictly telephone bonds, and except with respect to one telegraph bond those included in Moody's Investors Service list are likewise all telephone bonds.

On Exhibit C-43 Mr. Petty shows for the year 1923 and six months of 1924, the bond yields to investors of the New York Telephone Company (the same as in Exhibit C-41), the yields at market prices of the company's 6.5 per cent. preferred stock, the yields of the 8 per cent. common stock of the New England Telegraph & Telephone Company at market prices and a composite yield at [fol. 34] market prices of all securities of the New York Telephone Company, the latter being based on the assumption that the yield on the New York Telephone Company's 8 per cent. common stock (not on the market) would be as much as that on the common stock of the New England Telegraph & Telephone Company.

The company's brief criticizes Mr. Petty's use of the yield on the

common stock of the New England Telegraph & Telephone Company on grounds not clearly apparent. His testimony clearly indicates that the capital set-up of the New England Telegraph & Telephone Company is substantially the same relatively as that of the New York Telephone Company; that a substantial amount of its common stock is on the market, and quotations thereon from month to month are readily available; further that it had such a deficit in revenue that it failed to earn 40 per cent. of its common dividend in 1923. It naturally follows that as the safety of the dividend is endangered, the market price of such stock will decrease and the yield which will attract an investor to buy the stock must be increased.

Taking the yield on this stock, then, where the dividend is somewhat in jeopardy, will lead to assigning a higher market price of capital for the common stock of the New York Telephone Company based on such yield than if a company whose dividend was more assured were taken. The natural result of this is to increase the estimated composite cost of capital to the New York Telephone Company when related to all of its securities.

Graph A on Exhibit C-43 shows the yields to investors in bonds of the company at market prices averaged for the year 1923, 5.34 per cent. and for the first six months of the present year, 5.30 per cent. and that the yield on its preferred 6.5 per cent. stock for 1923 averaged 5.92 per cent. and for 1924 5.91 per cent. The yield on the 8 per cent. common stock of the New England Telegraph & Telephone Company for the year 1923 was 6.93 per cent. and in 1924, when the deficiency in earnings during 1923 became public, the yield began to climb to such an extent that the average yield during the first six months of 1924 was 7.34 per cent. Applying these yields in the proportion that the respective securities of the applicant were outstanding in 1923 indicates that the composite yield to investors on the market prices of the various securities enumerated was 6.27 per cent., during 1923, and due to the use of the higher yield of the common stock of the New England Telegraph & Telephone Company the composite yield during 1924 had risen to 6.46 per cent.

On the basis of the actual figures relating to yield on the bonds and preferred stock of the New York Telephone Company and of the average yield for eighteen months of the common stock of the New England Telegraph & Telephone Company, on which the yield would probably be greater than that of the New York Telephone Company's stock, if it were on the market, the following table has been prepared to show a composite yield which would attract capital into the business, based on prices which the public has been paying for these securities.

Table II

Bonds, 38.2% of capital at 5.45% (10 year average investment yield) equals	2.08%
on entire capital.	
6½% Preferred Stock, 5.3% of capital at 5.94% of market yield, equals	0.31%
of entire capital.	
[fol. 35] Common stock, 56.5% of capital at 7.10% (18 months' average yield on New England Telegraph & Telephone Company's common stock) equals	4.01%
of entire capital	
Composite yield on all securities, based on market prices...	6.40%
Adding to this cost of financing bonds and stocks	*0.20%
Total	6.60%

The cost of financing in percentage of yield, as stated above, is twice that given by Mr. Gillette in his testimony. The preferred stock of the company was placed at less than \$100,000 cost on upwards of \$20,000,000 par value of stock as shown by the company's annual report to this Board.

The above table indicates quite clearly, we think, that the composite yield of 6.6 per cent. (including banker's fees) would attract the public to the securities of the company because, with respect to the first two classes mentioned, they were buying the securities at these yields and today at even lower yields.

A return of 7.5 per cent would give a margin of nearly 14 per cent above the cost to the company at the market prices of securities named, and a return of 8 per cent would give a cover or margin of upwards of 20 per cent. Based upon all the facts in the record, the Board is of the opinion that a return on capital in amount of from \$5,750,000 to \$6,000,000 will afford a fair return to the company on the fair value of its property herein fixed under existing conditions and with due regard to the future. If based on a strict reproduction cost of the financing of the company only, as of today, following the company's contention with respect to the basis of value to be taken in appraising its property, this return would probably be entirely too high, but the company must carry on through all conditions of the money market and the Board is of the opinion that the probable future average rather than the present price of money may reasonably be used in the instant case, especially in view of the fact that the Board must attempt to reasonably forecast the probable future cost of capital during the next few years, and not as of June 30th, 1924, alone.

*Twice the percentage indicated by testimony of Mr. Gillette for 20 year bonds in which the 3 per cent discount was assumed to be reflected in the yield. There is no discount on the stock.

Revenues and Expenses for 1924 Assuming the Proposed Rates to Have Been in Effect

In Exhibit P-16, the company submitted an estimate of the results of operation in 1924, assuming that the new rates were in effect throughout the entire year. For New York property devoted to New Jersey service an annual charge is added to "Rent and Other Deductions" and the value of such property has been deducted from the appraisal; "Depreciation Expenses" is made to conform to the findings relating thereto hereinafter stated.

Table III

Results under Proposed Rates—Estimates for the Year 1924

Revenues:	By Company (Exhibit P-16)	By Board (Ex- hibit C-34 modified)
Exchange Service	\$14,693,000	\$14,693,000
Toll Service	10,465,000	10,465,000
Miscellaneous Operating	257,000	257,000
Total Telephone Revenues	\$25,415,000	\$25,415,000
[fol. 36] Expenses:		
Traffic Expenses	\$5,846,000	\$5,846,000
Commercial Expenses	2,309,000	2,309,000
General and Miscellaneous Ex- penses	548,000	548,000
Uncollectible Operating Rev- enues	150,000	150,000
Rent and Other Depreciations ..	283,000	349,000 (1)
Current Maintenance	3,230,000	3,230,000
Depreciation Expense	3,452,000	2,678,000 (2)
Taxes	2,499,000	2,588,000 (3)
Licensee Revenue, Dr.	1,089,000	1,089,000
Total Telephone Expenses	\$19,406,000	\$18,787,000
Total Telephone Earnings	\$6,009,000	\$6,628,000

In Exhibit P-97, the company submits a statement of earnings and expenses for nine months. If these be regarded as three-fourths of year it would indicate a slight decrease in revenues and expenses. But the experience of 1923 indicates that the first nine months' revenues and expenses were less than 75 per cent of the year's total. The changes, then, to be made in expenses shown in Exhibit P-16, relate only to the three groups as noted. The statement indicates that the return based on Exhibit C-34, modified, would be \$6,628,000. This is \$878,000 in excess of the reasonable return of \$5,750,000 hereinbefore fixed by the Board for the year 1924, as a basis for

(1) Increased to provide for Administration Buildings (\$66,000—P-97).

(2) To conform to Exhibit C-34. ✓

(3) Increased to provide for increased income taxes on larger net revenues.

future rates, and would produce an excess above the rate of return which the company itself claims to be entitled to earn; nor does this take into account excess reserves hereinafter discussed. The Board cannot find, in view of these facts, that the rates proposed are just and reasonable as they produce more than a fair return on the fair value of the property of the company devoted to the service of the public, even after including as a charge to expenses the 4.5 per cent licensee revenue claimed by the company.

Operations under Existing Rates

We will next consider operations under the existing rate schedule as a test of future operations under present rates until such time as the reserves for depreciation, etc., hereinafter discussed, shall have been reduced to a normal figure. Expenses already charged in excess of the necessary amounts do not have to be charged a second time. The principal difference from those considered hereinbefore (assuming the new rates to have been in effect), relate to revenues and to taxes based on telephone net earnings.

Table IV

Results under Present Rates—Estimated for the Year 1924

	By Company (Exhibit P-14)	By Board, based on Exhibit C-34 modified
Revenues:		
Exchange Revenues	\$11,936,000	\$11,936,000
Toll Revenues	10,465,000	10,465,000
Miscellaneous Operating.....	257,000	257,000
Total Telephone Revenue.	\$22,658,000	\$22,658,000 (2)
Expenses:		
Traffic Expenses	\$5,846,000	\$5,846,000
Commercial Expenses	2,309,000	2,309,000
General and Miscellaneous Expenses	548,000	548,000
Uncollectible Operating Revenues	150,000	150,000
Rent and Other Deductions ... (1)	283,000	283,000
Current Maintenance	3,230,000	3,230,000
Depreciation	3,452,000	2,678,000
Taxes	2,170,000	2,200,000
Licensee Revenue, Dr.	965,000	965,000
Total Telephone Expenses	\$18,953,000	\$18,209,000
Total Telephone Earnings	\$3,705,000	\$4,449,000 ✓

(1) Include a certain portion of depreciation for right of way from clearing accounts.

(2) Omits concessions (\$102,000) and interest during construction (\$100,727) aggregating \$202,727 in Exhibit C-34.

[fol. 37] On the basis of Exhibit C-34 as modified by the Board and including the full amount of the normally required depreciation expense at \$2,678,000, the net telephone earnings for the year 1924 would be \$4,449,000. This is on the assumption, however, that the licensee revenue Dr. under the 4.5 per cent contract, as claimed by the company, is a proper charge to expenses and on the assumption that no excess charges and depreciation expense have been made heretofore. On that basis the return of \$4,449,000 is approximately \$1,300,000 below the fair return of \$5,750,000 as found by the Board herein; but, as herein found, the company has made excessive charges for depreciation expense in an aggregate amount of \$1,984,000 which amount is not required to maintain its investment at 100 per cent of its cost as contemplated by law. But having made such charges in the past, future charges beginning January 1st, 1925 may be decreased from the normal charge until such time as at least \$4,750,000 of this excess is absorbed as hereinafter provided for.

In the opinion of the Board, the company should, beginning January 1st, 1925, compute the total normal charges to depreciation expense by use of the annual depreciation rates as hereinafter provided. From the amount so computed it should deduct an amount sufficient to allow the net telephone earnings for a given period (month or year) to equal a fair return on the value of its property in service as herein found by the Board. These deductions should be made until their total is equal to \$4,750,000 herein found as the minimum amount which has heretofore been charged to depreciation expenses over and above the amount which will be found as a credit in the depreciation reserve to be set up on January 1st, 1925 as herein provided.

The result of this procedure will be that it will not be necessary for the company to collect as much from the rate payer for depreciation expense as it would have to charge if this excess balance in the depreciation reserve did not exist and will make it possible for the company to earn a fair return on the value herein fixed without resorting to an increase in its rates at this time.

The Board's treatment of this matter is not without precedent. See

In re Thompson (Ill.) P. U. R. 1922-A, p. 576.

In re Eaton Rapids (Mich.) P. U. R. 1922-D, p. 116.

In re Consumers Co. (Idaho) P. U. R. 1923-A, p. 430.

Annual Expense of Depreciation

The only complete study of the proper amount of depreciation accruing annually and to be taken care of by charges to depreciation expense, was made by Mr. C. G. Hill, at the request of the Board, and incorporated in Exhibit C-1. This is based on an exhaustive study of the history of the company covering in certain accounts, nearly thirty years. The company's expert in Exhibit P-101 (first sheet) pointed out that, with respect to twenty-one accounts there was but 0.1 per cent difference in amounts set up by the company's

percentages and those indicated by Mr. Hill in Exhibit C-1, but that in the remaining accounts a difference of \$588,175 resulted. These seven accounts at the company's present rates required, for 1923, a charge of \$1,650,231 against \$1,032,056 required by Mr. Hill's percentages.

In Exhibit P-101, sheet 1, Mr. Hill's various percentages for annual depreciation are applied to the individual accounts constituting in total the "average book balance, 1923" of \$59,342,876, including rights of way and general equipment, these individual amounts aggregating a total annual charge of \$2,458,513, or a composite percentage of 4.14 under Mr. Hill's percentages and \$3,045,472 under the company's rates or a composite percentage of 5.13 per cent. This leads to a discussion of depreciation rates and reserves.

What will be the total length of life of the several component parts of the telephone company's present plant, and what net salvage will ultimately be recovered when the present plant has completely passed out of existence, are questions involving considerable uncertainty. The solution would involve looking into the future a great many years, a number of years comparable with the remaining life of the most recently placed plant, parts of which, such as underground conduit, are admitted to have an average life of at least fifty years. The problem viewed from this angle is further complicated by the fact that both the average life and salvage have been and are still undergoing changes (Whittemore, testimony, page 2576). In the case of certain kinds of plant, Mr. Whittemore states that the average length of life is increasing (testimony, page 2684 and Ex. P-101, pp. 25 and 27). The most logical and practical point of view, therefore, seems to be that outlined by Mr. Hill (testimony, page 2470), that the rate at which the property is now depreciating should be determined by its present average life and salvage as determined from the past experience of the company, modified by any known changes in conditions to occur in the near future, which would affect the rate of depreciation. The true depreciation rate for any class of plant will, it appears, change from time to time with altering conditions. The rates for depreciation charged by the company on its books should therefore be modified frequently enough to keep pace as nearly as practicable with changing rates of depreciation of the physical property itself. Mr. Whittemore concurs with this proposition when he states "I think it may be true to the facts and avoid any troublesome and conflicting propositions, and they do come in, if we frequently revise these rates so they can be true as of the time, and each year or two be regarded as a closed chapter" (testimony, p. 2587).

Not only will the current rate of depreciation vary, but also the required, or normal reserve for accrued depreciation associated with any part of the property will change from time to time because of alterations in the two underlying elements governing depreciation, to wit: the average life and the salvage. A primary purpose of the reserve for accrued depreciation is to maintain the company's capital investment unimpaired through providing out of earnings a fund

which, accumulating year by year, will offset the net losses occurring when the company's property is retired from service. This is true as to each item of the company's property.

It follows that an increase in length of life and increasing salvage with respect to any class of plant will tend to cause a decrease in the required or normal amount of the reserve for accrued depreciation associated with that class of plant. A competent study to determine the adequacy, inadequacy, or amount of excess of the existing reserve for accrued depreciation above its required or normal amount should from time to time be made, and such excess or deficit in the depreciation reserve should be dealt with as may seem most desirable in each specific case.

[fol. 39] In this case we have a depreciation study covering the above subject made on behalf of the Commission by Mr. Hill (Exhibit C-1) and a critical analysis of this study made for the company by Mr. Whittemore (Exhibit P-101). Mr. Hill's study is concerned largely with a determination of the average life of each class of plant from the company's experience in northern New Jersey as exhibited by its books and records from the earliest available data down to the end of the year 1923, and a determination of net salvage for each class of plant from an investigation of the company's experience during the ten years from 1914 to 1923, inclusive. Mr. Hill has testified that in his opinion the experience of the company in New Jersey is, with one or two exceptions, the best indication of the average life and salvage to be expected in the New Jersey Division in the near future, inasmuch as a careful study of the records of the company and of the company's plans as far as appears by the record has revealed no such changes in conditions as to cause any radical alteration and assumptions as to the average lives and salvages indicated by the company's experience (testimony, page 2477). Exhibit C-1 prepared by Mr. Hill, shows that the annual expense of depreciation charged by the company in its operating expenses in 1923 exceeded the annual rate at which the property actually depreciated during that year by \$631,253 and that the reserve for accrued depreciation as of December 31st, 1923 exceeded the required or normal amount of that reserve by \$1,309,751 (Exhibit C-24). The Company's reserve for accrued depreciation has increased from a negligible amount (5 per cent.) in 1912 to over 25 per cent of the total plant and general equipment at the end of 1923 (Exhibit P-101, p. 5). Under the company's present depreciation rates this depreciation reserve is still increasing at a rate out of all proportion to the company's requirements. This is indicated by Exhibit C-1, on Table N. J. 201, from which it appears that the appropriations for depreciation in 1913, were approximately \$500,000 more than required or 25 per cent. in excess of requirements or of the depreciation actually accrued for that year. The fact that the percentage relation of depreciation reserve to book cost of plant has not increased during 1923, as pointed out by Mr. Whittemore (testimony, page 2585) is not significant, since it results from the dilution of the old plant by an unusually large amount of new plant added in 1923, against which there has not been time as yet

to accumulate a large reserve. When the rate of growth of the plant diminishes the ratio of depreciation reserve to plant will increase more rapidly.

The company has produced no evidence in support of the particular depreciation rates applied by it to specific classes of plant, nor have the company's witnesses been willing to express even an opinion as to what the depreciation reserve should be at the present time, or to what extent, if at all, the present depreciation reserve is excessive. Mr. Whittemore has stated that the excess of the depreciation reserve above actual requirements, or "cushion", should not exceed two or three per cent (testimony, page 2588). In answer to the question, "Have you figured the percentage of excess now existing," he says, "I don't know what the excess is. I don't know there is any."

The company's witnesses have made no criticism of Mr. Hill's method of determining the required or normal depreciation reserve after the average life and salvage are determined. In his testimony [fol. 40] (page 2582), Mr. Whittemore points out that for a given class of plant, the same average life and salvage are used in determining both the rate of depreciation and the normal amount of the reserve. This would seem self-evident since the depreciation reserve is built up from accumulations of the annual depreciation allowances. Referring to the depreciation rates and normal reserves as found by Mr. Hill, Mr. Whittemore says, "They are tied together and one is only an arithmetical extension of the other. If these rates be found faulty, upon an examination of this data, then there is the alternative, that the excess disappears with it." If Mr. Hill's arithmetical method be correct, which Mr. Whittemore does not question, the converse of the above proposition also holds, that if these depreciation rates are found correct, upon an examination of the data, then, as a consequence, the estimated excess of the depreciation reserve is also proved.

Average Life

The average life figures given in Exhibit C-1, Table N. J. 204, are attacked by the company in the case of the following accounts only:

	Company	Hill
Central Office Equipment.....	Not Shown	16 years
Exchange Aerial Cable.....	14 years	20 years
Exchange Underground Cable Subsidiary..	15 years	20 years

Central Office Equipment.

The company contends that sixteen years is too long an average life for the present central office plant in northern New Jersey. As evidence they show in Exhibit P-101, pages 10 to 18, the average ages of the investment in equipment in each of the central offices. Of the total central office equipment in the New Jersey Division, having a reproduction cost of \$18,274,000 the central office equip-

ment for which the probable date of retirement is known amounts to only \$1,266,338, or about 6.9 per cent. (Exhibit P-28, P. 20.) Of this 6.9 per cent. of the central office equipment, the average age of the equipment in the various offices at the time of retirement of the office varies from four years to a little more than eleven years. These figures seem to support an average life of sixteen years with actual retirements grouped by years of age symmetrically about the average life, as described by Mr. Hill (testimony, page 2868). On Table N. J. 213-a, of Exhibit C-1, in column (4) the percentage of plant surviving after nine years of life is 92.2 per cent., which indicates that 7.8 per cent. of the central office equipment should be retired during the first nine years of its life.

Whenever, as in the present case, certain units of a group are retired at an early age and other units at a more advanced age, it is apparent that in a growing plant the great majority of the retirements must consist of the short lived elements, since the longer lived elements included in the large gross additions in recent years will not be retired for many years to come. The average age of the investment in plant units retired or about to be retired, such as the central offices listed on page 14 of Exhibit P-101, must, therefore, be substantially less than the average life of the entire group of units. The more rapid the rate of growth of the plant, the greater the difference between the average age of plant retired and the average life of the entire plant. In the case of central office equipment in northern New Jersey the growth in recent years has been very rapid, seven and one-half million dollars out of a total book cost of twelve million dollars having been added in the [fol. 41] last three years (1921, 1922 and 1923) as shown by Table N. J. 213-a of Exhibit C-1. If these last three years' additions, against which comparatively little reserve has been accumulated (not more than 20 per cent. of the total reserve) be eliminated from the book cost, the ratio of depreciation reserve to fixed capital for central office equipment, shown on page 5 of Exhibit P-101, as 33.26 per cent. on December 31st, 1923, becomes approximately 75 per cent. That is, the depreciation reserve associated with plant more than three years old amounted on December 31st, 1923, to about 75 per cent. of that plant, whereas the company's engineers can foresee the retirement of only about fifteen per cent. of this plant. Exhibit P-28, page 20, shows about 6.9 per cent. of the entire central office equipment scheduled for retirement, which would be about 15 per cent. of the central office equipment reduced by the last three years' additions. It would seem very difficult to justify the need for such a large reserve or for the depreciation rates upon which it was built up.

The remainder of Exhibit P-101 relating to the life of central office equipment sets forth the average age of equipment in those central offices which are not scheduled for retirement. The comparatively low average ages of these offices proves beyond a doubt that very large additions have been made to the central office equipment in recent years, but the evidence appears to be quite irrelevant to the question of average life as a whole, since the attained age is in

itself no criterion of the total age to be attained before ultimate retirement. No computations are made and no quantitative conclusions are drawn in company Exhibit P-101, relating to the age of central office equipment at the present time, as there shown, to its average life.

In his analysis of the statistical data drawn from the company's records relative to the average life of central office equipment, Mr. Hill has applied two distinct statistical methods. The first method, given on Tables N. J. 213-a and b of Exhibit C-1, is based upon the assumption that some parts of the central office equipment plant are retired after a shorter period of service than are other parts, so that the retirements are grouped about the average life, some above and some below the average age. The resulting average life computed on this basis varies but little with changes in the particular form of distribution of retirements about the average life which may be used (testimony, pages 1903-1904). The company also states the proposition of the distribution of age of retirements about the average life in the case of central office equipment in Exhibit P-101, page 9, as follows: "Because of these characteristics (i. e. the manner in which the investment in a given central office grows from year to year), it follows that upon retirement of any central office, analysis will disclose its parts to be of various ages. They vary from one year or less, upwards to that of equipment surviving from the initial installation." As an illustration, it appears, therefore, that a part of the manual central office equipment in "Lambert" office has already attained an age of twenty-four years (Exhibit P-101, p. 11), and a much greater age will be reached since the retirement of Lambert office is not as yet foreseen by the company's engineers. (Compare offices scheduled for retirement, Exhibit P-28, p. 20.)

Since the age of the dollars invested in equipment in each central office are distributed above and below an average age of the investment, it follows that there must be such a distribution of retire-[fol. 42] ments by age for the central office equipment account as a whole. The company's principal objection to Mr. Hill's central office equipment study seems to be directed to his analysis based upon this assumption of distribution by age of the retirements of central office equipment.

The second statistical method used by Mr. Hill in his analysis of central office equipment is based upon an assumption which will give a result most favorable to the company, that is, will produce a shorter average life for central office equipment than any other reasonable method of analyzing the company's statistics (testimony, page 1909). This method shown on Table N. J. 214, Exhibit C-1, is based upon the assumption that all retirements of central office equipment occur at the same age, that age being the average life for this class of plant as a whole. The process of computation consists in accumulating the gross additions year by year, starting with the year 1923, until the sum of the gross additions is equal to the book cost as of December 31st, 1923. This is not, strictly speaking, an actuarial method, and it was applied by Mr. Hill to

the central office equipment and building accounts, only. In the case of central office equipment the resulting average life was fifteen years, an approximate agreement with the average life of sixteen years developed by the first method above described. The company has offered no criticism of the statistical method exhibited on Table N. J. 214, of Exhibit C-1, nor has it questioned Mr. Hill's statement (testimony, page 1909) that this alternative method used by him produces the shortest average life of any method which it would be reasonable to apply to the company's experience to determine the average life of central office equipment.

Average life used by the company, fourteen years, found by Mr. Hill, twenty years (Exhibit P-101, page 25).

The company claims to have made a study of the life of aerial cable in 1916, which resulted in finding an average life of ten years. It is not stated whether this study related to the New Jersey Division or to the company as a whole, or to New York City. This average life was considered too short to apply to conditions during and immediately following the war and was increased by the company to fourteen years, an increase of forty per cent. The average life of aerial cable is admittedly growing longer, but the company submits no figures as to how fast this change is taking place. Mr. Hill's study, based upon the company's experience in the New Jersey division, shows an average life of 20 years as of the end of 1923, or an increase of about 40 per cent. over the life used by the company for conditions as they were during and immediately following the war. The company's present depreciation rates should be based upon the average life now, not the life as it was determined in 1916 or 1919, and on this subject the company has produced no evidence.

Criticism is made on page 25 of Exhibit P-101 of the net additions to aerial cable during years 1892 to 1896, as shown on Exhibit C-1, Table N. J. 222-b. Mr. Hill stated (testimony, page 1878) that the net additions used in Exhibit C-1, were taken from the company's books and records for northern New Jersey and they have been checked with an historical study made by Mr. Petty, the Commission's engineer, in 1916, (data underlying Exhibit C-17, 1916 case) the correctness of which has not been in any way challenged by the company.

[fol. 43] Exchange Underground Cable-Subsidiary

Average life used by the company, fifteen years, found by Mr. Hill twenty years (Exhibit P-101, p. 27).

It is admitted by the company that the average life of this class of plant has been increasing, and no evidence has been submitted to show that Mr. Hill's determination of 20 years, based upon the company's experience in New Jersey Division, is unreasonable.

Salvage

The salvage figures used by Mr. Hill in Exhibit C-1, are questioned by the company in the case of the following accounts only:

Central office equipment.
Station apparatus.
Private branch exchange.
Exchange Underground cable-subsiidiary.

Central Office Equipment

Salvage used by the company, 10 per cent. Salvage found by Mr. Hill, 20 per cent.

Mr. Hill has stated that in arriving at his estimate of salvage he considered both the salvage credited on the company's books during the last ten years, and specific instances of the retirement of entire central offices, where such were available, in both northern and southern New Jersey (testimony, page 2471). As an example he cites the retirement of the Atlantic City toll board in 1923, where the net salvage was about 30 per cent. This is the most recent instance of the retirement of a large central office in New Jersey. Mr. Whittemore's criticism of Mr. Hill's figure of 20 per cent for salvage on central office equipment appears to be based upon what Mr. Whittemore thinks conditions may be between sixteen and thirty years in the future. As representing the salvage now and in the immediate future there appears to be no objection to the figure of 20 per cent. Mr. Whittemore says, (testimony, page 2595) "Another point with reference to these findings of Mr. Hill is his net salvage of 20%. That means that when all this apparatus comes out, years ahead, and this type of apparatus is no longer functioning, no longer standard, something is able to take its place, an average of sixteen years from now, or perhaps thirty-two years, then we still find this apparatus worth twenty cents on the dollar." In the first place, proof is entirely lacking that sixteen or thirty years from now manual central office equipment will no longer be functioning in the smaller central offices. In the second place, as Mr. Whittemore himself has said in another part of his testimony, we are not now concerned with conditions as they will be sixteen to thirty-two years from now. In speaking of the depreciation rates and reserves, Mr. Whittemore said, "These rates have been revised quite frequently * * * and if they be adjusted as we go along, excessive errors one way or the other will be avoided. * * * Try to see what the next two or three years will be, what is apt to be the salvage, be right as you go along and revise frequently and then there will be no trouble with planting too much in the reserve" (testimony, p. 2587).

This is sound reasoning, and were the principal as stated followed consistently by the company, the greater part of the differences between Mr. Hill's findings of average life and salvage, and those advocated by Mr. Whittemore would disappear.

If it were possible to forecast with reasonable assurance of accuracy the remaining life of all of the present central offices, and the salvage to be recovered when the longer lived equipment is retired, perhaps upwards of sixteen years from now, such data would properly be given weight in determining the present depreciation rate. On the other hand, the same data would also be applicable to the determination of the existing depreciation due to inadequacy and obsolescence of the company's central office equipment. The only central offices, the approximate dates of retirement of which are definitely foreseen by the company, are listed on page 20 of Exhibit P-28. The reproduction cost of such offices is \$1,266,338, which is about 6.9 per cent. of the total central office equipment. This represents all the central office equipment the retirement of which is definitely foreseen by the company, since Mr. Whittemore testified, (testimony, page 1618) that "if I knew as a fact there was an office scheduled to come out five years from now, I think I ought to make mention of the fact, and I would. So that the item shown on page 8 (Exhibit P-28) which amounts to \$2,146,000 for those instances I could see, would be increased by that amount." The next six months, following December 31st, 1923, according to Mr. Whittemore's testimony (page 2432) disclosed no further instances of coming retirements of central office equipment.

An average salvage value of 8 per cent. was used by the company in computing the manifested inadequacy of central office equipment (Exhibit P-28, page 20). This salvage appears to be too low in the light of Mr. Hill's testimony, and the salvage actually recovered on recent retirements of central offices. A higher salvage would tend to reduce the percentage for inadequacy. On the other hand if the retirement of central offices to be displaced after the year 1927, which is provided for in the annual depreciation rate for central office equipment, had been considered, the manifested inadequacy would have been increased. The use of too low a salvage may be regarded as offsetting to a limited extent the fact that the retirements of central office equipment after the year 1923 are not included in the Company's estimate of depreciation due to inadequacy.

Station Apparatus.

Salvage used by the company, 72 per cent. Salvage found by Mr. Hill, 82.3 per cent.

Mr. Hill's figure for salvage is, as shown on Table N. J. 206, Exhibit C-1, an average of the salvage actually recovered by the company on station apparatus during the years 1914 to 1923, inclusive. The company objects to the use of so high a percentage for salvage for the reason that the average book cost per unit of station apparatus is increasing. The book cost per unit may be expected to stabilize at about \$12 per unit, according to the company's figures, as shown in Exhibit P-101, page 21. If the salvage is 82.3 per cent., the average value recovered per set due to reuse would be \$9.88 (see page 32, Exhibit P-101). In the examination of Mr.

Whittemore (testimony pages 2674 and 2681) is was brought out that there is a relationship between the salvage recoverable on station apparatus and the structural value of the station apparatus in the company's plant. The amount of physical deterioration existing in station apparatus at its retirement was estimated in Exhibit P-28, page 26, as 10.2 per cent. of the reproduction cost. Mr. Whittemore testified that this figure should be increased slightly to make allowance for the small percentage of subscriber's sets which is junked and not reused. In any event the correction on the above percentage is not large, (testimony, pages 2676 and 2678. This figure [fol. 45] of 10.2 per cent. represents substantially the average depreciation of station apparatus when it is retired, as stated in Exhibit P-28, including as part of that depreciation the cost of repairing sets for reuse. If such repairs were charged against the depreciation reserve, we would expect the salvage of station apparatus to be at not far below 89.8 per cent. As a matter of fact the repairs amounting to \$1.30 per set, as shown by the Company, Exhibit P-28, are largely charged against operating expenses (Hill, testimony, page 2873). It would follow, therefore, that if station apparatus were charged in and out of the plant at the same figure (reproduction cost new), the salvage recoverable would be less than 100 per cent. by an amount representing only the small percentage of junked subscriber's sets and certain losses on minor and miscellaneous materials. It appears, therefore, that 82.3 per cent. may be too low rather than too high an estimate of the salvage recoverable from such station apparatus, during the next few years, in which reused sets will go into the plant at a current cost substantially higher than the average unit at which retired sets are written off the books.

Private Branch Exchanges.

Salvage used by the company, 67 per cent. Salvage found by Mr. Hill, 78 per cent.

The similarity between the private branch exchanges and station apparatus accounts which led the company to use the same method in determining structural value for each, is stated in Exhibit P-28, page 31. For the same reason as stated in connection with station apparatus above it appears that if the cost of removal be neglected the company's finding of structural value for private branch exchanges, 87.2 per cent. is probably somewhat lower than the salvage which would be recovered, because the 12.8 per cent. depreciation includes some costs or repairs which are charged to operating expenses. The cost of removal would amount, according to the company's figures, (Exhibit P-101, page 24), to about 2.6 per cent. which would not bring the net salvage recoverable down to as low a figure as that used by Mr. Hill in his study, namely 78 per cent.

Exchange Underground Cable-Subsidiary.

Salvage used by the company, 10 per cent. Salvage found by Mr. Hill, 18.1 per cent.

The difference between these two figures is to some extent accounted for by a difference in point of view between the company and Mr. Hill (testimony, page 2876). The company appears to be attempting to estimate the salvage for all time to come, whereas Mr. Hill is finding what salvage may be expected for the next few years, bearing in mind always the possibility of adjusting the figure to meet new conditions should they appear in the next four *four* or five years. Exchange underground cable subsidiary is a comparatively long lived class of plant. Mr. Hill finds that the company's experience shows an average life of twenty years (Exhibit C-1, Table N. J. 204). The reproduction cost level, at which salvage is credited on the Company's books, is now substantially above the book cost, which represents the cost level at which plant is retired, and because of the long life of the plant, this condition will continue for many years to come.

Examination of Table N. J. 206 of Exhibit C-1, showing net salvage by classes of plant for the years 1914 to 1923 inclusive, shows that the salvage on all the cable accounts varies widely and [fol. 46] irregularly from year to year. Therefore, it appears hazardous to draw conclusions from the percentage salvage shown by the company's books in any one or two years, as the company has attempted to do in the argument on page 27 of Exhibit P-101. The most reasonable method of determining the probable salvage on cable for the next few years is to consider the average salvage actually recovered by the company over a period in the past which includes a number of low years and a number of high years, thereby smoothing out their regularities which occur from year to year. This method was the basis of Mr. Hill's estimate of 18.1 per cent. salvage on exchange underground cable subsidiary for the next few years.

Reserves for Depreciation and Amortization of Intangible Capital

As of December 31st, 1923, the company's book balances to the credit of these two reserves were as follows (Exhibit P-95):

Reserve for Depreciation—account 102.....	\$16,571,338
Reserve for Amortization of Intangible Capital—account 103 (rights of way, etc.).....	331,192
Combined totals (to provide for depreciation).....	<u>\$16,902,530</u>
Mr. Hills Exhibit C-1, p. 1, indicates that all the balance that is required after providing for all existing depreciation, with a cushion of over 30 per cent, as indicated to be necessary by the past twenty-five years' history of the company (after making a minor correction) is.....	<u>\$12,692,135</u>

The excess therefore over all probable requirements is, as of December 31st, 1923.....	<u>\$4,210,395</u>
--	--------------------

For 1924 the increase in excess reserve is indicated by the following figures:

The company's estimate credit (Exhibit P-14)	\$3,452,000
The normal amount required Exhibit C-24)	<u>2,678,386</u>
Increase in excess credits so indicated	773,614
Total excess as of December 31st, 1924	<u>\$4,984,009</u>

In order to be conservative and allow for any reasonable variations in the company's estimated credit to this reserve for 1924, this figure of \$4,984,009 will be taken as \$4,750,000 in the final conclusions herein arrived at.

The ledger cost new as of December 31st, 1923 of the property with which the reserve of \$16,902,530 is associated, was \$61,801,932. (Exhibit C-1, Table 203) of which amount the actual reserve of \$16,902,530 is 27.35 per cent, and the normal, or required reserve of \$12,692,135 is 20.5 per cent. Owing to the large 1924 plant additions, these percentages will be reduced by about 2 per cent, making them 25.35 per cent and 18.5 per cent respectively.

It will be helpful to ascertain what margin or "cushion" the normal or required reserve above indicated will afford over and above the total accrued depreciation which the company's expert has been able to find and for which it is the function of the reserve to provide. The following calculations will show this.

"Existing Deterioration" and "Manifested Inadquacy" are given [fol. 47] by Mr. Whittemore as of July 1st, 1924 in Exhibit P-98, p. 5. Eliminating therefrom construction in progress and land, (neither of which are subject to depreciation) we have the following:

Reproduction Cost of Property. Excluding Land and Construction in Progress July 1st, 1924, \$88,255,443

"Existing Deterioration" \$10,371,572 or 11.75%

"All seen coming inadequacy" 2,146,937 " 2.43%

of \$88,255,443

Total accrued depreciation observed. . 12,518,509 " 14.18%

These percentage relations are substantially the same as for December 31st, 1923. The reserves are to be related to the book cost of the property.

The company claims that only the "existing deterioration" of 11.75 per cent. should be deducted in arriving at the value of its property.

In view of the company's claim that the total deterioration which should be deducted from the value of its property is but 11.75 per cent., whereas the reserve on hand is about 25 per cent. of the cost of the depreciable property, it is apparent this excess is so great as to be unreasonable. In addition the Board also deducts what Mr. Whittemore calls "all seen coming inadequacy" of 2.43 per cent. as found by him, making a total deduction of 14.18 per cent., which, related to the 25 per cent. reserve still shows an unreasonable margin or "cushion."

The normal reserve of 18.5 per cent. as found by the Board, is about 57 per cent. in excess of the existing deterioration of 11.75 per cent. observed by Whittemore and is nearly 31 per cent. in excess of 14.18 per cent., the total observed depreciation. This cushion of 30 per cent. over and above all kinds of observed depreciation, which is all the depreciation the company's experts can find after diligent inspection, is certainly ample. The excess of \$4,984,000 over and above the required reserve, has been created by charges to expenses in the past but has not been spent and will not be required to provide for any depreciation which can be seen or which experience indicates should be provided for.

This is further emphasized by the fact that the percentage of accrued depreciation in 1916 was about 13.4 per cent. so that the observed percentage condition of the property has not varied one per cent. in an interval of eight years. Certainly no better guide as to the reasonable amount of the reserve can be found than the experience of the company.

The company has been on notice for years that it has been charging too much to expenses to create this reserve. As far back as the 1916 rate case the Board (Vol. V. N. J. P. U. R., p. 637) indicated that the company was charging an excessive amount to its expenses to provide for these reserves (\$110,387 minimum—\$394,544 maximum per annum). In 1919 the company claimed that it had charged \$418,000 too much to depreciation expense (VIII, N. J. P. U. R., p. 555).

The company claims (Exhibit P-101, page 7) that its annual net return on its New Jersey property has not averaged 8 per cent. for a number of years; citing 6.52 per cent. in 1921; 5.94 per cent. in 1922; 5.78 per cent. in 1923; and 5.76 per cent. in September, 1924, (on annual basis) on book value.

The earnings in the years preceding present a different picture. In a proceeding before the Board (VOL. V, N. J. P. U. R., p. 717) the company showed that it had earned the following returns, based [fol. 48] on the fair value of its property: in 1916, 10.96 per cent.; in 1917, 10.13 per cent.; in 1918, (estimated) 7.85 per cent. As the Postmaster General of the United States increased the rates on September 1st, 1918, the 1918 estimated return loses its significance. The earnings in 1919 based on the valuation of 1916 (continued by subsequent net additions, etc.), were 9.57 per cent. (VOL. VIII, N. J. P. U. R., p. 559). A development cost study, as of December 31st, 1916, introduced and not questioned in the 1916 rate case,

(Exhibit C-17 which showed that the New York Telephone Company or its predecessors had received, on the minimum basis, a return of \$4,821,000 in excess of an 8 per cent. compound interest return from the beginning of the business. The year 1916, included therein, is shown separately above.

The first application made by the company for increased rates was in 1919 when its application was granted, with certain exceptions. Notwithstanding its claim of insufficient return the company did not seek an increase in rates until the present application in 1924.

Where a utility neglects to apply for an increase in rates to which it is entitled the fault is its own (*Knoxville v. Knoxville Water Co.*, 212 U. S. 1; *Galveston Electric Co. v. Galveston*, 258 U. S. 388).

However, the above facts indicate that the company has received a return which was adequate or at least which did not move it to ask higher rates from 1921 to the filing of the present application in 1924. Furthermore, as already stated, it was on notice that it was charging too much to depreciation expense and it has, therefore, no reasonable ground to protest when the reserve is required to be reduced to an appropriate amount, "so that at the end of any given terms of years, the original investment remains as it was at the beginning" (*Knoxville v. Knoxville Water Co.*, supra).

The Board finds that the company has charged to expenses and credited to reserves, at least \$4,750,000 as above indicated, which amount is in excess of the amount warranted, and therefore, future charges computed at the depreciation rates hereinafter fixed should be decreased sufficiently to absorb this overcharge.

From the amounts ascertained by the application of the depreciation percentages hereinafter provided, on and after January 1st, 1925, the Board will direct the company to deduct such amount of depreciation expenses as will permit the resultant net telephone earnings to equal the fair return as herein found; this procedure to be followed until the excess credit of 4,750,000 above referred to is absorbed.

In fixing the annual rates of depreciation for the company's property in the New Jersey Division at this time, an important consideration is the fact that means are available for the adjustment of these rates in the future as often as may be deemed necessary by the company or by the Commission. If the rate of depreciation now fixed proves, in the light of further experience in future years, to be too high or too low, the remedy will be at hand, and by adjusting the depreciation rates frequently to conform to present, known conditions, irreparable injury can be done neither to the company nor to the public.

It is contended that the amounts to be charged to depreciation expense, resulting in the creation of a depreciation reserve, is solely a matter of business judgment to be determined by the company. This is, to a certain extent, true and might be wholly so were it not for the fact that this fund is accumulated from the rates and is an [fol. 49] important factor in determining the fairness and reasonableness of the rates. Under regulation it is a proper matter for scrutiny

by the regulatory body. If this were not so, there would be no limit to the amount that a utility might accumulate in its depreciation reserve and thus have, at the termination of its activities, not only 100 per cent. of its original property, but whatever additional amount it had been able to accumulate through charging excessive rates for depreciation. All that the law contemplates is that the company's investment shall be kept unimpaired.

The purpose of accumulating a depreciation reserve is, as stated in *Knoxville v. Knoxville Water Co.*, 212 U. S. 1, "so that, at the end of any given term of years, the original investment remains as it was at the beginning."

The Supreme Court of the United States in *Louisiana R. R. Comm. v. Cumberland Tel. Co.*, 212 U. S. 414, held that it was improper to raise more money than was necessary for the purpose. ✓

The depreciation reserve belongs equitably to the customers and the business. It having been collected from the rate payer for a specified purpose, becomes impressed with a trust and cannot be used for the payment of dividend or any other purpose.

Knoxville case, *supra*.

Cumberland case, *supra*.

Whitten on Valuations, p. 363.

The policy of this State with reference to the treatment of depreciation in the property of a public utility and the maintenance of a reserve therefor is indicated by the statutory provision found in Chapter 195, P. L. 1911, Sec. 17, which empowers the Board to require a public utility to carry a proper and adequate depreciation account and fix proper and adequate rates of depreciation. The Act provides that this fund "shall not be expended otherwise than for depreciation, improvements, new constructions extensions or additions to the property of such public utility."

It will be observed that this Board is empowered to fix rates of depreciation and in *Georgia Ry. & Power Co. v. R. R. Com.*, 262 U. S. 25, it was held that the determination of the rate (of depreciation) is a question of fact.

The License Contract

The company does not maintain its own research and development department, a research laboratory, a fundamental engineering department or other similar departments, nor does it own the telephone instruments (transmitter, receiver and induction coil). The American Telephone & Telegraph Company does maintain such departments and facilities and owns all the telephone instruments furnished to the associate companies. In the early days of the telephone business telephone operating companies of necessity had to make "license contracts" with the company owning the original telephone patents (now the American Telephone and Telegraph Company) and were required to pay a royalty or instrument rental for the telephones furnished by the licensor company. The

original license contracts covered only the furnishing of instruments and under the contract the "licensor" was not required to furnish services of any kind. However, in the course of time it became the practice of the "licensor" company to furnish the "licensee" company certain technical, engineering and other services incident [fol. 50] to the conduct of the business. Therefrom there arose between the "Licensor" the American Telephone & Telegraph Company and its predecessors and the various operating companies, now known as associate companies of the Bell Telephone System a practice which gave to the operating companies not only the use of the instruments owned by the American Telephone & Telegraph Company (transmitter, receiver and induction coil) but also the use of all patents and protection in their use, the benefit of research and development work carried on by the American Telephone & Telegraph Company, accounting, legal, traffic, commercial and plant engineering and operating advice, financial assistance and other detail services directed toward making the telephone business uniform and efficient and standardizing its equipment and operations. These relations were also beneficial to the American Telephone & Telegraph Company in its business because of the standards established in equipment and service and the economies that may have been effected.

The royalties paid for the use of the transmitters, receivers and induction coils were reduced from time to time until January 1st, 1902 when the contract was modified to provide for payment on the basis of 4.5 per cent. of the gross revenues from telephone service. This change in method of payment very slightly reduced the average payment per telephone instrument under the license contract.

The present license contract which specifically states the various services to be rendered by the American Telephone & Telegraph Company was not made until 1920. It continues the basis of payment for services as 4.5 per cent. of gross telephone revenues as first provided in the 1902 contract.

[fol. 50] When the per cent. rate of payment was fixed it represented the cost of the service to the associated companies, which equalled 4.5 per cent. of their gross revenues from telephone service.

It appears from the testimony that for the year 1923 the New York Telephone Company, for the portion of its revenue allocated to the New Jersey service, paid to the American Telephone & Telegraph Company approximately \$850,000 representing 4.5 per cent. of its gross receipts, and it is estimated by the company that out of the revenue for 1924 it will pay the sum of approximately \$965,000. It is claimed that this expenditure represents an operating expense on the part of the company, and it asks that it be allowed as such in ascertaining a proper rate of return on the fair value of its property.

In determining rates it is necessary to ascertain the rate of depreciation, amount of operating expense, allowance for taxes, and other revenue requirements, and, in addition, the rate of return on the fair value of the property devoted to public use. A necessary and

important factor in determining a proper rate of return, is the propriety of the expenditures for operating expenses, both as to necessity and reasonableness in amount. The moneys paid under the license contract, at the rate of 4.5 per cent. of the gross revenues must, therefore be found from the proofs to be reasonable in amount and necessary and proper in the conduct of the company's business.

The Board can only act in the instant case in the manner prescribed by the Statute which defines the Board's jurisdiction in a proceeding of this nature and which also defines the duty of the utility in promulgating its schedule of increased rates. The company filed its proposed schedule of increased rates in accordance with [fol. 51] the Statute, and, pursuant thereto, the Board proceeded to hear proofs in order to determine whether or not the rates as proposed by the company are reasonable and just.

"When any public utility as herein defined shall increase any existing individual rates, joint rates, tolls, charges or schedules thereof, as well as commutation, mileage and other special rates or change or alter any existing classification, the board shall have power either upon written complaint or upon its own initiative to hear and determine whether the said increase, change or alteration is just and reasonable. The burden of proof to show that the said increase, change or alteration is just and reasonable shall be upon the public utility making the same." P. L. 1911, p. 378.

As the burden of proving that the proposed increased is just and reasonable is upon the company every element of expenditure for various revenue requirements which are a necessary part of the rate structure, must be established by it in order to enable the Board determine whether the schedule as proposed is just and reasonable.

As appears by the testimony, the American Telephone & Telegraph Company owns all of the common stock of the New York Telephone Company, except qualifying shares. The license contract was therefore entered into between two companies under conditions very different from those which ordinarily exist between contracting parties. While, theoretically, the contract is made between two parties dealing at arms length, in reality it was made by the American Telephone & Telegraph Company with itself. True, the mere fact of ownership of all the stock does not in itself give rise to any improper inferences, but the transaction requires close scrutiny to ascertain the fairness of the contract in its relation to the parties and its effect upon the public.

The United States Supreme Court on the question of contractual relations existing between two corporations, one of which is entirely owned and controlled by the other, states the rule as follows:

"Under the circumstances disclosed in the evidence the fact that the American Telephone & Telegraph Company controlled the company and the Western Electric Company by stock ownership is not important beyond requiring close scrutiny of their dealings to prevent imposition upon the community served by the company." *Houston vs. Southwestern Bell Telephone Company*, 259 U. S. 318; 66 L. Ed. 961.

A further indication of the necessity for that "close scrutiny" referred to by the United States Supreme Court is found in *Indiana Bell Telephone Co. v. Public Service Commission* (300 Fed Rep. 191-204) where grave doubt is expressed as to the method used in fixing the compensation for the services rendered under the license contract, the court saying: " * * * the companies should be able to devise some better method of fixing the compensation than 4.5 per cent. of the plaintiff's gross income."

The testimony offered by the Company does not attempt to accurately value the services rendered for which it pays 4.5 per cent. of its gross receipts, but is of a general character indicating the numerous services available and benefits accruing to the company which result in large savings. It is claimed that through the control of many inventions by the American Telephone & Telegraph Company and available to the company, there are extensive savings, amounting to millions of dollars, in the installation of equipment; [fol. 52] that the company has the use of all patents without royalty; that the American Telephone & Telegraph Company maintains a department for acquiring patents and defending litigations involving them; that legal and engineering services are available to the company at all times; and that financial assistance is likewise available at a lower cost than otherwise. It further appears that instrument service is supplied to the company as well as the services of the general staff which includes research and laboratory work.

The company endeavors to justify the payment under the contract on the ground that the saving involved, plus the benefits from other forms of service which could not be calculated, were more valuable than the amount of the payment of 4.5 per cent. of the gross receipts. This, in our judgment, is not a sound or logical method of determining the propriety of this expenditure. The testimony shows that in 1902 it was found that the total amount of the license payments then made to the American Telephone & Telegraph Company was equal to 4.5 per cent. of the then gross revenue of the associated companies. That percentage of the gross revenue was therefore fixed as a matter of convenience, as the basis for payment under the "license contract;" since that time, however, as the business of the companies has grown the amount of the payment has vastly increased in dollars and so, to some extent, have the services increased. But have the services increased in proportion to the increase of the payment in dollars? In 1902 the 4.5 per cent. payment amounted in dollars to \$89,529; in 1923 the 4.5 per cent. payment amounted to \$851,332. While the cost of the service to the associated companies was the original basis for determining the percentage, no attempt has been made by the company to show that the services today bear the same relations to the dollars paid today that they did in 1902, when it was ascertained that 4.5 per cent. of the gross receipts reflected the cost of the service to the companies. Furthermore, it appeared from the testimony of the company's witness that the cost of rendering the service was the underlying basis of the contract. Therefore, in view of the relations

between the parties and their expressed intention to have the amount of the payment reflect the cost, as this payment is reflected in operating expenses, in our judgment, cost becomes an important element in determining the propriety of the payment under this contract.

Furthermore, it appears notwithstanding that some part of these services, such as engineering, financing, and interest during construction, are not properly chargeable to operating expenses, but to capital account, yet they are included in the 4.5 per cent. payment which the company asks to be allowed as an operating expense. No attempt is made by the company to apportion the moneys paid under the license contract by allocating such charges as properly belong to capital account to that account, and such as properly pertain to operations to operating expenses, although in the 1916 case before this Board, Mr. Whittemore made an allocation of the percentage of services rendered under this contract which should be properly charged to capital account, which amounted to approximately one-third of the total paid under this agreement. In the proofs now before the Board it appears that some services are properly chargeable to capital account, but no proof is offered whereby the Board can determine the amount. It is impossible under the evidence offered by the company, to ascertain in dollars or in percentage how [fol. 53] much of the service rendered under this contract should be placed in either account. This further illustrates the fact that the evidence offered to determine the propriety of the expenditures under this contract is inadequate and incomplete in this respect and that the company has failed to establish this item by the burden of proof which is cast upon it by the statute.

A utility company might delegate its engineering, legal, administrative or other functions to a holding company or a subsidiary and enter into a contract to pay any stipulated sum for these services, but the mere existence of the contract at a prescribed rate of payment should not be the test of the validity or propriety of the expenditures thereby incurred. If the company performed these services itself it would apportion their actual costs between the capital accounts and the operating expenses much as is now the practice in apportioning engineering and supervision expenses. If these services were placed upon any other basis, it would involve the question of the reasonableness of the profit that a holding or other company thereby earns. It might be that the Board would have no jurisdiction over such other company and would be unable to obtain the evidence in order to give it that "close scrutiny" required by law and would therefore be arbitrarily bound by any contract existing between an operating company and the company that renders the service. These services are such as are ordinarily performed by the operating company itself and form, in general, a part of this necessary operating cost. If, because of economic or operating reasons, these functions are delegated to a central organization to perform, the expense incident thereto should be calculated, in a rate case, on the basis of what it would cost the operating company to render such services.

No rate schedule should be established which reflects the cost of services of a similar character at a higher rate or charge than the reasonable and necessary cost of rendering same.

There was no proof offered of the reasonable cost of rendering this service. During the progress of the case, the Board endeavored to ascertain from the company the cost of rendering the service allocated to the New Jersey territory. This information was not furnished by the company on the ground that the American Telephone & Telegraph Company refused to furnish the information from which the cost of this service could be ascertained. Inasmuch as the operating company is owned and controlled by the holding company, we must regard the refusal of the American Telephone & Telegraph Company to furnish this information as the refusal of the New York Telephone Company.

The opportunity for that "close scrutiny" of the relations between the companies in respect to this contract, contemplated by law, was not only prevented but made impossible. With the exception of the instrument charges, the company endeavored to prove the propriety of the expenditures involved in the 4.5 per cent. solely by an approximation of the resulting benefits which we find too indefinite and uncertain a basis upon which to determine the propriety of this charge, in view of the burden upon the company, under our law, of satisfying this Board that its proposed increase in rates is "just and reasonable."

It is apparent that the payment of 4.5 per cent. of the gross receipts becomes increasingly larger year after year as the business of the company increases and would be still larger with the proposed [fol. 54] increase in rates. It has no relation to the net income of the company or whether its business be profitable or not. Inasmuch as it is a fluctuating item, varying with the revenues, it does not always represent the fair and reasonable cost of rendering the service. This 4.5 per cent. payment, increasing as the business increases, will be a progressively larger sum, always to be earned from the rates. The rate payer should never be required to pay more than will represent the reasonable cost to the company of rendering the services which it elects to have someone else perform for it. An increase in rates will automatically increase the payments. The increase in payments increases the operating expenses, and increased operating expenses, are urged as a reason for rate increases. This seems to be traveling in a circle.

Through its ownership of all the common stock of the New York Telephone Company, the American Telephone & Telegraph Company will receive all dividends paid on its stock. If the 4.5 per cent. payment was not made in its present form, the American Telephone & Telegraph Company would still receive it in the form of dividends for what it failed to pay out by way of operating expenses would be net earnings for distribution to the stockholders. This further illustrates, first, the necessity for close scrutiny of the relations between the companies under this contract, and, second, the determination of the cost to the company to perform the service itself. It is

clear that if the aggregate payment was less than estimated for the year 1924, that the rates to be paid by the public for telephone service would be proportionately lower than proposed by the company in its rate schedule.

While the Board recognizes the fact that the services rendered the company by the American Telephone & Telegraph Company under the license contract are valuable to it, the difficulty the Board labors under is its inability to determine that value in view of the general and vague character of the evidence introduced, except as to instrument service, which is but approximately one-third of the whole. Nor is the Board unmindful of the fact that the payments under this contract have apparently been approved in other jurisdictions but it does not appear that any of these cases arose under a statute similar to ours.

However, as there is no proof before the Board of the cost of rendering these services, nor of what it would cost the company to supply like service itself, nor of the basis on which the payments should be apportioned between operating expense and capital, the Board is forced to the conclusion that the petitioner has failed to establish, by the burden of proof as required by our statute, that the increases in rates, predicated in part on the payments referred to, are just and reasonable.

Service

The Board made the hearings on the question of service available to all municipalities and the public. From a study of the proofs offered by the parties and the Board's investigation, it appears that the service errors, while numerous, are not an unreasonable percentage of the whole. The business is one in which the human element plays an important part and is carried on by means of delicate and complicated apparatus and, from its very nature, cannot be perfect. In view of the conclusions reached, however, no specific [fol. 55] finding on this question, as affecting the rates, is necessary.

State Wide Rates

In the course of the proceedings it was suggested that a State wide rate schedule should be adopted and the petitions of the company in this case and of the Delaware & Atlantic Telegraph & Telephone Company, which serves the southern part of the state, were filed with this in view. The Board deems it inadvisable to determine that question at this time and its determination will therefore be reserved for future consideration.

Conclusions

Upon considering the evidence, for the reasons hereinbefore stated, the Board finds and determines that the schedule of rates as filed is unjust and unreasonable and is therefore disallowed, for the following reasons:

1. The company has not sustained the burden imposed upon it by law to satisfy the Board that the proposed increase, change and alter-

ation in its existing rates, tolls, charges and schedules, is just and reasonable.

2. That at this time, with a proper allocation of expense for depreciation, the proposed rates would enable it to earn more than a fair return upon the fair value of its property devoted to the public use as found by the board.

The Board further finds and determines:

3. That the fair value of the company's property used and useful to the public is as of June 30th, 1924, \$76,370,000 and that it is entitled to earn a fair return thereon of approximately \$5,750,000.

4. That the company shall carry a proper and adequate depreciation account as herein provided:

(a) That the company shall set upon its New Jersey Division ledger an account entitled "Reserve for Depreciation, Credit" (code No. 102) and an account entitled "Reserve for Amortization of Intangible Capital, Credit" (code No. 103), the latter providing principally for retirement of rights of way. The amount to be set up as the balance on December 31st, 1923 to the credit of "Reserve for Depreciation, Credit" (102) shall be \$16,571,338 as shown in the company's Exhibit P. 95, and the amount to be set up as the balance on December 31st, 1923 to the credit of "Reserve for Amortization of Intangible Capital, Credit," (103) shall be \$331,192 as shown on the same exhibit.

(b) That the entries subsequent to December 31st, 1923 with respect to each of these reserves shall be made as required by the uniform system of accounts for telephone companies, prescribed by the Interstate Commerce Commission and adopted by this Board, and to accord with the findings herein.

(c) That on and after January 1st, 1925, the charges to "Depreciation Expense" (Account No. 106), "Amortization of Landed Capital" (account No. 340), for rights of way principally, and clearing accounts, (and concurrently credited to these reserve accounts) shall be computed by the application to the respective ledger balances of fixed capital in the following depreciation percentages:

Account	Annual depreciation rate %
Exchange Right of Way.....	5.26
Toll Right of Way.....	4.55
Buildings.....	2.67
Central Office Equipment.....	5.00
Other Equipment at Central Offices.....	5.38
[fol. 56] Station Apparatus.....	2.95
Station Installations.....	1.00
Interior Block Wire.....	4.00
Private Branch Exchange.....	3.14
Booths and Special Fittings.....	3.47
Exchange Pole Lines.....	7.66
" Aerial Cable.....	4.45
" " Wire.....	10.50
" U. G. Conduit, Main.....	1.33
" " Subs.....	4.00
" " Cable, Main.....	1.95
" " " Subs.....	4.09
" Submarine Cable.....	4.54
Toll Pole Lines.....	5.09
Toll Aerial Cable.....	2.42
Toll Aerial Wire.....	3.47
Toll U. G. Conduit.....	1.33
Toll U. G. Cable.....	2.17
Toll Submarine Cable.....	3.73
Office Furniture and Fixtures.....	5.27
Interest During Construction.....	4.28
Store Equipment.....	5.75
Stable and Garage Equipment.....	15.46
Tools and Implements.....	13.33

These percentages are stated on an annual basis but may be translated to a monthly basis by proportion.

(d) That, beginning with January 1st, 1925, the debits to expenses as provided in 4(c) foregoing shall be decreased by an amount which will permit the resultant net telephone earnings to equal the fair return on the fair value of its property in service as indicated herein, continued to subsequent dates by the use of book net additions, and the difference shall be charged to expenses and concurrently credited to the proper reserve. When the total deductions from the normally required depreciation expense shall have aggregated a total of \$4750,000 such deductions shall be no longer made.

(e) That the property or assets constituting the depreciation fund, equal in amount to the sum of the two reserves above referred to under 4(a), shall be used in manner provided by law.

(f) That, as of December 31st, 1924, the total credits of these two reserves are herein found to be in excess of the amount required for

maintaining the company's investment at 100 per cent of its original cost by at least \$4,750,000.

Dated, December 31st, 1924.

Board of Public Utility Commissioners, by (Signed) H. V. Osborne, President.

Attest: (Signed) Alfred N. Barber, Secretary. (Seal.)

I hereby certify the foregoing to be a true copy of a decision rendered by the Board of Public Utility Commissioners and ordered filed by the said Board.

Alfred N. Barber, Secretary. (Seal.)

[fol. 57]

Appendix I

Exhibit P-96

Book Balances of Fixed Capital Construction in Progress as of June 30th, 1924, Rearranged and Condensed

Property groups

Tangible Fixed Capital—	Amounts— cents omitted
Rights of Way.....	\$924,004
Land	599,679
Buildings	4,175,023
Total Central Office Equipment.....	15,397,369
Total Station Equipment.....	9,020,931
Total Exchange Lines.....	27,976,693
Total Toll Lines.....	11,026,384
Total General Equipment.....	1,199,552
Interest during Construction and Undistributed Construction Expenditures	674,600
Total Tangible Fixed Capital in Service	\$70,994,265
Total Intangible Fixed Capital	522,135
Total Fixed Capital	\$71,516,400
Construction in Progress—Not in Service	2,363,473
Total Fixed Capital and Construction in Progress	\$73,879,878

Original 1923 Appraisal of Company

Reproduction Cost New and Structural Value of Plant, General Equipment, Working Capital (Exhibit P-29, Sheet 2) and Preliminary Costs and Going Concern Value (Exhibit P-44, All as of December 31st, 1923)

Portions of property	Reproduction cost	Physical deterioration		Structural value, amount
		Physical deterioration	Manifested inadequacy, etc.	
(1) Rights of Way	\$1,757,611		\$52,728	\$1,704,883
Land	1,571,557			1,571,557
Buildings	7,739,404	\$1,007,496	72,578	6,659,330
C. O. Equipment	18,290,538	896,519	874,064	16,519,955
Station Equipment & Outside Plant	58,249,154	8,057,611	1,153,748	49,037,795
General Equipment	1,224,949	408,648		816,301
Total Plant & General Equipment in Service	88,833,213	10,370,274	2,153,118	76,309,821
Working Capital	2,064,963			2,064,693
Total Including Working Capital	90,898,176			78,374,784
(2) Preliminary Costs & Going Concern Value	11,782,000			11,782,000
Grand Total	\$102,680,176	\$10,370,274	\$2,153,118	\$90,156,784

Note.—Construction in Progress is included in above amounts. Book Cost of same was \$2,363,478—Appendix I.
 (1) Includes overheads.
 (2) From Exhibit P-44.

Condensed Summary of Cost of Reproduction New—Wholesale Construction Basis as Submitted by J. G. Wray & Co. in Exhibits C-26 and C-27 and Including Working Capital as in Exhibit C-25 and Intangible Values as in Exhibit C-53 (Includes N. Y. Administrative Buildings)

Groups of property	N. J. division, values new	Farmers division, values new	Total values new
Tangible Fixed Capital:			
Rights of Way	\$1,702,724	\$20,733	\$1,723,457
Land	1,329,145	(2)	1,329,145
Buildings	7,147,093	(2)	7,147,093
C. O. Equipment.....	17,722,014	15,248	17,737,262
Total Station Equipment..	8,727,593	26,451	8,754,044
Total Exchange Lines....	32,225,370	191,061	32,416,431
Total Toll Lines.....	12,184,564	52,523	12,237,087
Total General Equipment.	1,220,501	4,448	1,224,949
(1) Total Tangible Fixed Capital			
(New)	\$82,259,004	\$310,464	\$82,569,468
Working Capital (3).....			1,253,881
Total Tangible Capital.....			\$83,823,349
Intangible Capital Ex. C-53.....			3,446,843
Total as of Dec. 31st, 1923.....			\$87,270,192

NOTE.—Reproduction Overheads are used which were charged later to conform to the company's account practices.

(1) Includes Construction in Progress, book cost of which was \$2,997,464.

(2) Included in N. J. Division Amounts.

Appraisals of New York Telephone Company's Property as Set up by G. W. Whittemore, for the Company and J. G. Wray & Company for the Board—Continued from the Original Appraisal as of 12/31/23 to 7/1/24 with the Various Corrections and Adjustments Noted

New York Telephone Co.—G. W. Whittemore				J. G. Wray for the board			
Source		Sub-total	Amount	Source		Sub-total	Amount
(a) Reproduction Cost New as of 12/31/23 including value of N. Y. Administrative Bldgs. Allocated to service of New Jersey Division, and construction in progress.				Ex. C-26 & 27.			
Ex. P-29 sh. 3 (1).		.....	88,833,213*	.....		.....	82,569,468*
Deduct—Correction in Buildings..		488,526	.....	372,767		.....	.....
Deduct—Error in Drop Wires....		141,203	.....	.....		.....	.....
Ex. P-98 (2).		.....	.....	.....		.....	.....
Ex. P-98.		.....	.....	.....		.....	.....
(b) Sub-Total		629,729	.....	372,767		.....	.....
(c) Deduct for C. O. E. Price Changes		1,612,728	.....	1,660,208		.....	.....
Ex. P-98.		.....	.....	.....		.....	.....
(d) Total deductions and corrections..		.....	2,242,457	.....		2,032,975	.....
(e) Reductions of overheads to accord with accounting records.....		.....	3,445,511	.....		337,371	.....
(f) Total deductions from original appraisal .....		.....	.....	.....		.....	.....
(g) Reproduction Cost New as of 12/31/23 .....		.....	5,687,968	.....		.....	2,370,346
.....		.....	83,145,245*	.....		.....	80,199,122

*Includes construction in progress in amount not set forth. The book cost was \$2,997,354. Wray's figures, based primarily on Whittemore's inventory.

(1) Submitted May 14th, 1924.

(2) Submitted Nov. 7th, 1924.

Appraisals of New York Telephone Company's Property—Continued

	New York Telephone Co.—G. W. Whittemore			J. G. Wray for the board		
	Source	Sub-total	Amount	Source	Sub-total	Amount
(h) Deduct value of N. Y. Administrative Buildings.....	Ex. P-99.	.....	677,412	Ex. P-99 Adjusted.	.....	656,663
(i) Reproduction Cost New as of 12/31/23 of N. J. physical property.....	.....	.....	82,467,823*	.....	.....	79,542,459
(j) Add gross additions 12/31/23 to 7/1/24 at 7/1/24 price level.....	Ex. P-99.	.....	6,935,658	.....	6,935,658	.....
(k) Deduct retirements same period at appraisal price level.....	Ex. P-99.	.....	1,160,352	.....	1,144,224	.....
(l) Net Additions 12/31/23 to 7/1/24..	.....	.....	5,775,306	.....	.....	5,791,434
(m) Reproduction Cost New N. J. property as of 7/1/24.....	.....	.....	88,243,139*	.....	.....	85,333,893
(n) Deduct construction in progress 7/1/24 adjusted prices.....	.....	.....	2,190,425	Ex. P-99 Gross.	.....	2,363,476
(o) Reproduction Cost New N. J. Plant in service.....	Ex P-99.	.....	86,052,714	.....	.....	82,970,417
(p) Deduct "Existing Deterioration" ..	Ex. P-99.	.....	9,939,177	Ex. C-30.	.....	9,286,980
(q) Reproduction Cost New N. J. Plant in service less "deterioration" ..	Ex. P-99.	.....	76,113,537	.....	.....	73,683,437
(r) Deduct "Manifested Inadequacy", ..	Ex. P-99.	.....	2,071,794	Ex. C-30.	.....	2,149,764
(s) Reproduction Cost New N. J. Plant in service less Total Depreciation ..	.....	.....	74,041,743	.....	.....	71,533,673
(t) Add Going Value.....	.....	.....	11,782,000	Ex. C-53.	.....	3,446,843

(u) Depreciated Value of Plant in Service in N. J.	87,823,743	Ex. C-25 cont'd to 7/1/24 (adjusted)	74,980,516
(v) Add Working Capital.	2,571,900	"000" omitted.	1,770,000
(w) Total value of property included by Board (Table 1)	88,395,643		76,750,516
(x) Add Construction in Progress 7/1/24 Prices	2,190,425		2,363,478
(y) Appraised Value of all property ...	90,586,068		79,113,994
(z) Value claimed as a basis for rates Ex. P-99 sh. (3)	90,467,437		.....
			1-B.

(3) Plus 2% on \$2,190,425 construction in progress in addition to interest included therein.

Appendix V

Exhibit C-22, Submitted by Mr. Petty, Continued from December 31st, 1923, to July 1st, 1924, by Net Additions,
Rearranged to

(A) Eliminate Value of Administrative Buildings
(B) Adjust Same to C. O. E. Prices Effective July 1st 1924
(C) Deduct Depreciation Based on Inspection

Groups of property		Deprecia- tion, exist- ing deterioration	As per J. G. Wray Co., manifested inadequacy	Depreciated value, 7/1/24
Tangible Fixed Capital				
Rights of Way	Value new, amount, 7/1/24			
Land (excluding administration buildings) ..	\$2,399,816			
Buildings (excluding administration buildings)	1,165,933			
C. O. Equipment at 7/1/24 prices	5,579,942			
Station Equipment	16,251,971			
Exchange Lines	10,549,354			
Toll Lines	32,486,780			
General Equipment	10,776,236			
Interest during Construction & Misc. Cons. Exp.	1,065,353			
	670,351			
<hr/>				
Tangible Fixed Capital	\$80,945,736	\$9,057,828	\$2,080,305	\$69,807,603
Intangible as fixed by Board	3,600,000			3,600,000
<hr/>				
Total Fixed Capital	\$84,545,736	\$9,057,828	\$2,080,305	\$73,407,603
Working Capital as Fixed By Board	1,770,000			1,770,000
<hr/>				
Totals as of 7/1/24	\$86,315,736	\$9,057,828	\$2,080,305	\$75,177,603
Construction in Progress	2,363,478			2,363,478
<hr/>				
Totals	\$88,679,214	\$9,057,828	\$2,080,305	\$77,541,081

Index to Exhibit "A"

(Order and Decision of Board dated 12-31-24)

	Page
Conclusions	99
Depreciation	
Accrued in Plant and Property	46
Annual Expense of	64
Annual Rate fixed by Board by Property Accounts	100
Average Life	69
Aerial Cable (Exchange)	74
Central Office Equipment	69
Underground Cable, Subsidiary (Exchange)	75
Salvage	75
Central Office Equipment	75
Private Branch Exchanges	79
Station Apparatus	78
Underground Cable, Subsidiary (Exchange)	80
Fixed Capital, Values of	33
Book Balances of and Construction in Progress (Appendix I)	103
Intangible Value (Preliminary Cost and Going Concern value)	44
Tangible Fixed Capital—Value of Plant and Property in Service—	
Appraisal for State by J. G. Wray and Co.	36
Book Value	33
Company's Appraisal	33
Construction in Progress	39
1916 Appraisal Continued and Appreciated	38
Revision of Company's Appraisal	35
Summary of Fixed Capital, Table 1	41
[fols. 60 & 61]	
License Contract (4½ %)	88
Rate of Return	53
Reserves for	
Depreciation and Amortization of Intangible Capital	81
Revenues and Expenses	
Under Proposed Rates for 1924	60
Under Existing Rates for 1924	62
Service	98
State-wide Rates	99

	Page
Values, Recapitulation of, by Board 6/30/24	52
Condensed Statement by Board of Company's Original 1923 Appraisal (Appendix II)	104
Condensed Statement by Board of Cost of Reproduction New (Appendix III)	105
Appraisal of New York Telephone Company's Property (Comparison between Whittemore's and Wray's Set-up) (Appendix IV)	106
Appraisal by Mr. Petty of Board (Appendix V)	107
Working Capital	48
Payment to A. T. & T. Co. under License Contract as affecting Working Capital	51
Working Cash	49

[fols. 62 & 63] [File endorsement omitted.]

[fol. 64] IN UNITED STATES DISTRICT COURT

[Title omitted]

AFFIDAVIT OF FRANKLAND BRIGGS—Filed Jan. 25, 1925

STATE OF NEW YORK,
County of New York, ss.:

Frankland Briggs, being duly sworn, deposes and says:

I am an attorney and counselor at law of the State of New York and an attorney at law of the State of New Jersey and am the Attorney in Charge of Commission Matters of the New York Telephone Company, the plaintiff in this suit.

I have charge for said Company of all matters and proceedings before the Board of Public Utility Commissioners of the State of New Jersey, which Board has had general jurisdiction and powers of supervision and regulation over plaintiff and other public utility corporations since the year 1911.

I have charge of the filing of schedules of rates with said Board and all schedules so filed are issued in my name.

On March 6, 1924, I filed with the Board of Public Utility Commissioners on behalf of plaintiff new schedules of rates for exchange telephone service in plaintiff's New Jersey territory. The rates appearing in the new schedules were generally increases over the rates then in effect and were filed to become effective April 1, 1924. On the 11th day of March, 1924, said Board issued an order suspending such rates until July 1, 1924. A copy of this order is hereto attached and marked "Exhibit F. B. No. 1." On the 30th day of June, 1924, said Board issued a further order continuing the suspension until October 1, 1924. A copy of this order is hereto attached and marked "Exhibit F. B. No. 2." These orders, suspending the rates, were issued pending investigation of the rates which

was commenced on the 27th day of March, 1924, and carried on by frequent hearings held thereafter. The investigation being still uncompleted on October 1, 1924, the period of suspension was further extended by consent of the plaintiff until January 1, 1925, as evidenced by a letter dated October 14, 1924, written by me to the President of said Board, a copy of which is hereto attached and marked "Exhibit F. B. No. 3." Hearings in the investigation continued to be held up to December 5, 1924, the last hearing being held on that date. Throughout the entire proceedings I was in charge of the presentation of the plaintiff's case.

On December 31, 1924, the said Board made the order complained of in this suit.

(Sd.) Frankland Briggs

Subscribed and sworn to before me this 29th day of January, 1925. (Sd.) Edward C. Ryder, Notary Public. Notary Public for Queens County. Certificate filed in New York County. New York County Clerk's No. 321. Registers No. 5274. My Commission Expires March 30, 1925. (Seal.)

[fol. 65] EXHIBIT F. B. No. 1 TO AFFIDAVIT OF FRANKLAND BRIGGS

STATE OF NEW JERSEY:

BOARD OF PUBLIC UTILITY COMMISSIONERS

In the Matter of the Schedules Filed by THE NEW YORK TELEPHONE COMPANY Increasing Rates and Charges for Telephone Service.

Order Calling Hearing and Suspending Increase

The New York Telephone Company having filed with the Board of Public Utility Commissioners schedules increasing rates and charges for telephone service to become effective on the first day of April, 1924, the Board, upon its own initiative, hereby orders a hearing to be held upon the question whether the increase, change or alteration submitted by the said company is just and reasonable, and fixes Thursday, the twenty-seventh day of March, 1924, at eleven o'clock in the forenoon, as the time, and its rooms, 790 Broad Street, in the City of Newark, as the place of said hearing.

The Board pending hearing and determination hereby orders the increase, change or alteration suspended until the first day of July, 1924, unless the Board prior to such date shall be satisfied that the said increase, change or alteration is just and reasonable, and shall approve the same.

Dated March 11th, 1924.

Board of Public Utility Commissioners, by (Signed) H. V. Osborne, President.

Attest: (Signed) Alfred N. Barber, Secretary. (Seal.)

I hereby certify the foregoing to be a true copy of Order adopted by the Board of Public Utility Commissioners at a meeting held Tuesday, March 11th, 1924, and recorded in the minutes of said meeting.

(Signed) Alfred N. Barber, Secretary. (Seal.)

[fol. 66] EXHIBIT F. B. No. 2 TO AFFIDAVIT OF FRANKLAND BRIGGS
STATE OF NEW JERSEY:

BOARD OF PUBLIC UTILITY COMMISSIONERS

In the Matter of the Schedules Filed by THE NEW YORK TELEPHONE
COMPANY Increasing Rates and Charges for Telephone Service.

Order Further Suspending Increases

The Board of Public Utility Commissioners having issued an order suspending until the first day of July, One thousand nine hundred and twenty-four, certain increases, changes or alterations in rates proposed to be made effective April first, One thousand nine hundred and twenty-four, by the New York Telephone Company, and hearing not having been concluded, the Board pending hearing and determination,

Hereby orders a further suspension of said increases, changes, or alterations for a further period not exceeding three months from the first day of July, One thousand nine hundred and twenty four, unless the Board prior to the expiration of the said three months shall be satisfied that the increases, changes or alterations are just and reasonable and shall approve the same.

Dated June 30th, 1924.

Board of Public Utility Commissioners, by (Signed) H. V.
Osborne, President.

Attest: (Signed) Alfred N. Barber, Secretary. (Seal.)

I hereby certify the foregoing to be a true copy of Order Further Suspending Increases adopted by the Board of Public Utility Commissioners at a meeting held Monday, June 30th, 1924, and recorded in the minutes of said meeting.

Alfred N. Barber, Secretary. (Seal.)

[fol. 67] EXHIBIT F. B. No. 3 TO AFFIDAVIT OF FRANKLAND BRIGGS

October 14, 1924.

Honorable Harry V. Osborne, President Board of Public Utility Commissioners, State of New Jersey, 22 Washington Place, Newark, New Jersey.

DEAR SIR: In view of the fact that the statutory period for the suspension of the rates of the New York Telephone Company and The

Delaware and Atlantic Telegraph and Telephone Company, filed to take effect April 1, 1924, expired on October 1, 1924, it seems desirable to have some formal statement of the understanding of the Board and counsel as to the rates under suspension.

As stated in my letter to the Secretary of the Board, dated September 25, 1924, the companies consented to charge subscribers during the month of October at the old rates. We are well aware that in a case of this magnitude time is required to analyze the testimony and exhibits and to check the figures and we know that there has been no lack of diligence or unreasonable delay and that it is the intention of the Board to proceed as speedily as possible, nevertheless, assuming the rates filed to be reasonable, which the companies believe their proof has shown, the companies are failing to earn substantial revenues to which they are entitled during each month in which the old rates are continued in force.

As the Board believes that it will be impossible to complete the investigation in the present month the companies will consent to extend the suspension period to January 1, 1925, if it be agreed that the case be presented and closed in sufficient time so that the Board's order shall provide that the rates which it approves shall become effective January 1, 1925.

It is understood that this letter may be made part of the record if in the opinion of the Board or of counsel it should be advisable to have it so made.

Yours very truly, (Sd.) Frankland Briggs, Attorney in Charge of Commission Matters.

FB. CRL.

[fol. 68] IN UNITED STATES DISTRICT COURT

[Title omitted]

AFFIDAVIT OF HENRY C. CARPENTER—Filed Jun. 25, 1925

STATE OF NEW YORK,

County of New York, ss:

Henry C. Carpenter, being duly sworn, deposes and says:

I reside at 465 West End Avenue in the Borough of Manhattan, City, County and State of New York.

I am General Manager of the plaintiff Company and as such have charge of all the operating departments of that Company and am familiar with all branches of its business and with its method of conducting the same, and with its plant and property.

I was graduated in the year 1899 from Columbia University with the degree of Electrical Engineer and in the same year entered the employ of the plaintiff and have been continuously employed by the plaintiff since that time. Until January 1, 1912, I held various positions in the Engineering Department and on that date was made Engineer in charge of the Engineering Department. On November

1, 1919, I was made Chief Engineer of plaintiff and held that position until January 1, 1924, when I was made General Manager of plaintiff, which position I still hold.

The plaintiff owns and operates telephone lines and exchanges and conducts a public telephone business in the following Counties of the State of New Jersey: Hudson, Essex, Bergen, Passaic, Morris, Union, Middlesex, Somerset, Monmouth, Sussex and parts of Ocean and Burlington Counties as well as in the greater part of the State of New York and in the town of Greenwich in the State of Connecticut.

Plaintiff furnishes exchange telephone service and intrastate and interstate toll telephone service. During all the times referred to in the Bill of Complaint plaintiff's telephone system has been used in, and devoted to, the transmission of both intrastate and interstate communications, according to the requirements of its subscribers and patrons. Its said system has at all times been constructed and operated so as to furnish at all its telephones, and to all its patrons and subscribers, facilities for both intrastate and interstate communications, and said plant and system in the State of New Jersey are continually used in interstate commerce. It has at the present time in its entire system 516 central offices or exchanges. Of said central offices 99 are within the territory operated by plaintiff in [fol. 69] the State of New Jersey and the remainder are located in the States of New York and Connecticut.

The plaintiff owns in the State of New Jersey 40 parcels of land and has in operation in said State of New Jersey more than 1,678,868 miles of electrical wires, by far the greater part of which are composed of copper.

The plaintiff now operates in its entire system upwards of 2,250,356 telephones or, as they are commonly referred to in the telephone business, "stations." Of said number of stations 361,968 are in the State of New Jersey and the remainder are located in the States of New York and Connecticut. The plaintiff has in the State of New Jersey more than 259,205 accounts with subscribers and the average number of monthly bills which it has to send to subscribers in said State on account of service furnished to them is in excess of 248,287 and the present average monthly bill rendered to such subscribers on account of exchange service is less than \$3.15. The volume of telephone traffic handled by the plaintiff in the State of New Jersey is indicated by the fact that originating messages (that is to say messages sent from stations in New Jersey) during the year 1924 were as follows:

Local messages	297,448,456
Toll "	60,274,816
Long Distance messages	870,977

The plant and property of the plaintiff is at all times kept in first-class condition by making currently all proper repairs and renewals so that from an operation and service standpoint all of the plant and property in its entire system is at all times in a 100% operating condition.

The business of the plaintiff requires large amounts of new capital continually and this is so because of the continual growth of the business and on account of its character. As each new subscriber or user of the service is added to the system it is necessary to install a new telephone, wiring and equipment, furnish a copper circuit running from the place where the telephone station is located to the central office from which the telephone is served, and a separate location on the switchboard at such central office. As the capacity of the switchboards of the plaintiff is filled up it requires the installation of new switchboards, apparatus and equipment, the rearrangement of central offices and the acquisition of additional real estate and the construction of new buildings, the total cost of which runs into great sums of money. The actual expenditures made by plaintiff for additional property and construction during the years 1922, 1923 and 1924 were as follows:

Year 1922:	Gross additions	Net additions
Entire system	\$61,727,602	\$52,304,617
State of New Jersey	9,230,636	7,930,306

Year 1923:		
Entire system	\$82,787,395	\$72,026,511
State of New Jersey	9,868,150	8,140,035

Year 1924:		
Entire system	\$90,291,708	\$75,803,053
State of New Jersey	15,398,352	13,107,745

The following amounts will be expended necessarily by the plaintiff for additional property and construction during the years 1925 and 1926.

Year 1925:	Gross additions	Net additions
Entire system	\$72,635,000	\$56,969,000
State of New Jersey	13,907,890	10,983,890

[fol. 70] Year 1926:		
Entire system	\$62,169,000	\$45,936,000
State of New Jersey	10,630,000	8,021,000

Large expenditures for additions to the property of plaintiff will have to be continued in the years subsequent to 1926 to enable the plaintiff to meet the requirements of its service.

The average number of telephones or stations actually in service and operated by plaintiff in the State of New Jersey during the year 1924 was 344,991. A careful estimate and study made by me, using all available information, statistics and data, shows that the average number of telephones or stations which will be in service and operated by plaintiff in the State of New Jersey during the year

1925 will be 381,000. A careful study and estimate made by me of the average cost of the property of plaintiff which will be used or useful in and devoted solely to the rendition of its intrastate telephone service in the State of New Jersey, including necessary working cash during the year 1925 is as follows:

Fixed capital	\$64,643,059.99
Construction work in progress	2,413,981.81
Working cash	1,573,521.90
Supplies	654,731.92
Total	\$69,285,295.62

A careful study and estimate made by me of the revenues and expenses of plaintiff attributable to the rendition of its intrastate telephone service in the State of New Jersey during the year 1925 is as follows:

Revenues:

Exchange Service	\$13,281,000.00
Toll Service	3,534,478.00
Miscellaneous	233,495.79
Total Telephone Revenues	\$17,048,973.79

Expenses:

Current Maintenance	\$2,914,410.21
Depreciation and Amortization	3,359,669.85
Traffic	5,258,944.64
Commercial	1,960,550.95
General and Miscellaneous	469,447.47
Uncollectible Operating Revenues	96,499.31
Taxes	1,622,808.29
Rent Expense and Deductions	267,896.69
Miscellaneous Deductions	44,377.58
License Contract Expense	736,131.02
Total Telephone Expenses	\$16,730,747.01
Net Telephone Earnings	\$318,226.78

A careful study and estimate made by me of the average cost of the property of plaintiff which will be used or useful in and devoted solely to the rendition of its telephone service in the State of New Jersey, both intrastate and interstate, in the year 1925 is as follows:

Fixed capital	\$82,758,648.12
Construction work in progress	2,925,059.39
Working cash	1,981,200.00
Supplies	838,200.00
Total	\$88,503,107.51

[fol. 71] I have also made an estimate of the revenues and expenses of plaintiff attributable to the rendition of its telephone service in the State of New Jersey both intrastate and interstate in the year 1925, the figures being shown in the following table:

Revenues

Exchange Service.....	\$13,281,000.00
Toll Service.....	11,113,000.00
Miscellaneous	316,269.00
Total Telephone Revenues.....	24,710,269.00

Expenses

Current Maintenance.....	3,453,400.00
Depreciation and Amortization.....	4,128,000.00
Traffic	6,404,465.00
Commercial	2,657,000.00
General and Miscellaneous.....	589,166.00
Uncollectible Operating Revenues.....	140,000.00
Taxes	2,269,691.00
Rent Expense and Deductions.....	325,744.00
Miscellaneous Deductions.....	56,813.00
License Contract Expense.....	1,041,695.00
Total Telephone Expenses.....	21,065,974.00
Net Telephone Earnings.....	3,644,295.00

At all times referred to in the Bill of Complaint in this suit the telephone business of the plaintiff in the State of New Jersey has been conducted efficiently and economically and is now being so conducted. The operating expenses of the plaintiff have been and are being kept at as low a level as is consistent with the proper maintenance and operation of the plant and said operating expenses at the present time and during the past are and have been fair and reasonable. The expenses which have been incurred during the times referred to in the Bill of Complaint in this suit and in this affidavit are the actual expenses deemed necessary by the managing officers of the plaintiff to meet the actual conditions which have confronted it and which now confront it in the rendition of its telephone service. Existing conditions are not in my judgment abnormal or temporary but will continue for at least several years into the future. The charges made by plaintiff to operating expense for depreciation during the year 1924 were fair and reasonable.

(Sd.) Henry C. Carpenter.

Subscribed and sworn to before me this 29th day of January, 1925. (Sd.) Edward C. Ryder, Notary Public, Notary Public for Queens County. Certificate Filed in New York County. New York County Clerk's No. 321 Registers No. 5274. My Commission Expires March 30, 1925. (Seal.)

[Title omitted]

AFFIDAVIT OF GEORGE W. WHITTEMORE ON VALUE OF PROPERTY—
Filed Jan. 25, 1925STATE OF NEW YORK,
County of New York, ss:

George W. Whittemore, being duly sworn deposes and says:

I reside in the Borough of Brooklyn, City, and State of New York. I was graduated from Columbia University in 1890 and thereafter took a post-graduate course in electrical engineering in said University. I entered the telephone business in 1892, spending the first year in the office of the District Superintendent of the American Telephone and Telegraph Company. Following that I spent seven years in the Engineering Department of said telephone company doing general engineering work. In 1899 I became the Engineer of the Bell Telephone Company of Buffalo and two or three years thereafter became its General Plant Superintendent as well and was continuously employed by that company in engineering work until the year 1910. During that time I was in charge of all matters relating to the construction and maintenance of the physical property of that company and was engaged in increasing the size of its plant from about two million to eleven million dollars, which, at that period, was a large construction program for a telephone company. In 1910 I was employed by plaintiff, the New York Telephone Company and have since that date remained in the employ of said company being engaged exclusively in engineering and appraisal work.

I am thoroughly familiar with telephone properties and with the work, labor and materials entering into the construction of same and with the units of cost thereof and in the regular course of my employment I have appraised telephone properties situated in the States of New York, New Jersey, Maryland, West Virginia and Ohio and in the District of Columbia, the aggregate value of which runs into hundreds of millions of dollars. I have given particular attention to the analysis of all construction costs incurred by telephone companies.

I am thoroughly familiar with the entire property of plaintiff company including that portion of same located in the State of New Jersey and devoted by it to the furnishing of telephone service in said State. I have made an inventory and appraisal of said property with the help and assistance of a large force of employees working under my supervision and direction. In the course of my [fol. 73] employment in such work I have made a valuation as of the present time of all the property used or useful in and devoted exclusively by the plaintiff to the rendition of its intrastate telephone service in the State of New Jersey. In arriving at the

present fair and reasonable value of the said property hereinafter stated, I have taken into consideration, among other things, the following facts and matters—

(a) The cost of reproduction new of said property as found by the inventory and appraisal above referred to. My estimate of reproduction cost new was made by using the actual quantities or units of property making up the plant and system of plaintiff in the State of New Jersey, used or useful and devoted exclusively to the rendition of intrastate telephone service as of December 31, 1923 and applying thereto the prices of materials and labor current as of that time. The reproduction cost of said property in the State of New Jersey as of December 31, 1923 as determined in the manner above stated was \$3,000,000 dollars. With the foregoing estimate of reproduction cost new as of December 31, 1923, as a basis, I made an estimate of the reproduction cost new of said property used or useful and devoted exclusively to the rendition of intrastate telephone service by plaintiff in the State of New Jersey as the same existed on July 1st, 1924. I made such latter estimate in the following manner—

First, I added to the reproduction cost as of December 31, 1923 the gross additions to the property between January 1st, 1924 and July 1st, 1924, as taken from the books at actual cost.

Second, I subtracted the plant which had been retired from service during that period valued at the same amounts at which I had previously included them in my estimate.

Third, I then made due allowance for certain reductions in the cost of telephone equipment occurring since January 1st, 1924.

Fourth, I gave consideration to the appraisals of land and buildings owned by plaintiff throughout the State of New Jersey as determined by disinterested appraisers familiar with real estate values in the various localities in which the parcels of land were located and with the cost of constructing buildings in such localities. The said appraisals of such land and buildings show an average value of 60% over the cost of such land and buildings as shown on the books of the plaintiff.

By the above method I have found that the reproduction cost new of the physical property not including materials and supplies of plaintiff used or useful and devoted exclusively to the rendition of its intrastate telephone service in the State of New Jersey was \$68,000,000 dollars as of July 1st, 1924.

In the following table these figures are shown in detail by property groups:

Rights of Way	\$1,270,000
Land	1,320,000
Buildings	6,030,000
Central Office Equipment	15,700,000
Station Equipment and Outside Plant	42,978,000
General Equipment	1,002,000
Total Plant and Equipment	<u>\$68,000,000</u>

(b) The original cost of said property as stated in the affidavit of Harland A. Trax, Chief Accountant of the plaintiff, verified the 29th of January, 1925.

(c) Working Cash Capital and Materials and Supplies.—The [fol. 74] amounts for these items included by me in my appraisal represented the average amounts per station for said items which the plaintiff, as shown by its records, had actually been providing and using in recent years in the rendition of its telephone service, multiplied by the number of stations in New Jersey receiving such service on the date of my appraisal. From the working cash items, as used by me, I excluded all cash applicable to the payment of interest, dividends or taxes, as well as cash received from sale of securities wherewith to build or enlarge the plaintiff's property. I have read the portion of defendant's decision (Exhibit "A" to Bill of Complaint) dealing with working cash capital and have noted therein that, based on its own judgment, defendant has reduced such working cash capital by over \$700,000 under that provided in recent years by plaintiff, as shown by its records. Based upon a careful study of plaintiff's actual experience and requirements for working cash during recent years, and upon my experience in examining and appraising properties and operations of other telephone companies, I have estimated the amount of working capital, including materials and supplies, devoted by plaintiff to the rendition of its intrastate telephone service in the State of New Jersey, as of July 1st, 1924, at not less than \$2,015,000.

(d) Existing Depreciation.—The property of the plaintiff is and has been at all times during my employment by plaintiff, in a 100% operating condition. I have from time to time observed, inspected and examined said property and parts thereof and am familiar with its general physical condition. I have taken into consideration in arriving at its present fair and reasonable value such depreciation for its intrastate property as actually exists and have deducted 9,075,000 dollars on that account.

(e) Going Value.—I made a careful and detailed study to determine the cost of reproducing the business and organization of plaintiff in addition to the cost of reproducing the physical plant and property. I assumed that the minimum practicable time required for construction of a property and business, such as that owned by the plaintiff in New Jersey would be 5 years. I further assumed that at the end of that period the company would have not only a physical property, but an organization and an attached business similar to that which it now has. I assumed that during the construction period the plaintiff would commence to render service at the earliest possible date and would increase such service as fast as the construction of its facilities permitted. I assumed further that the revenues earned by plaintiff during the construction period would be based upon rates in accord with those filed by plaintiff with said Board on March 6, 1924, and disallowed by Board in its said order. The revenues so realized during the construction period I deducted from

the aggregate expenditures assumed to be made by plaintiff during that period, both for the construction of its plant and the operation thereof. Such revenues during the construction period were as assumed by me in excess of the operating expenses for said period. The method employed by me gave a result which, in my opinion, should be considered as a minimum cost of developing the business and property of the plaintiff in New Jersey. As a result of such study, I estimate the property of plaintiff used or useful and devoted to the rendition of its intrastate telephone service in the State of New Jersey, with its present corporate and operating organization and attached business has a value of \$9,010,000, over and above the [fol. 75] reproduction cost of the physical property alone. The Board in its said decision refers to my method of estimating the going value as one that "will produce a smaller going value than if the company is assumed to be less successful and completes the plant and attaches the business less rapidly" and that it would, therefore, produce a larger going value for a less successful than for a more successful company. These statements have no application to the method used by me and would indicate unfamiliarity by the Board with said method. The method used by me took no account of financial losses in the past, either actual or theoretical. On the contrary, every favorable assumption was employed. The construction period was, in my opinion, the shortest conceivable practical one. The assumption as to the commencement of service was that it would be started as soon as any portions of the plant were ready for service. The revenues were assumed to be on a higher rate than the Commission itself has allowed in its order. The Commission further states that the figures for going value found by my method could be widely varied by "a few reasonable modifications in assumption," the modifications to which it refers being the shortening of the construction period from a 5 to a 4 year period, which, in my opinion, would be practically unattainable; the use of percentage rates of return during construction and development period less than an amount which the said Board in its said order finds to be fair; the double deduction of certain expenses, such as the cost of securing stations and training of operating forces.

After giving careful consideration to all of the facts and matters above enumerated to the history, character and location of the property of the plaintiff and to all other factors and matters affecting the value of the property, it is my opinion that the fair and reasonable present value of the entire property of the plaintiff used or useful and exclusively devoted by it to the rendition of its intrastate telephone service in the State of New Jersey is in excess of 69,950,000 dollars. In arriving at the present fair and reasonable value above stated I have made no allowance whatever for the value of any of plaintiff's franchises or rights to own and operate a telephone system in said State. A summary of my said estimate of present fair and reasonable value of plaintiff's said property as of July 1st, 1924, is as follows:

Plant and equipment.....	\$68,000,000
Working Cash.....	1,430,000
Materials and Supplies.....	585,000
Going Value.....	9,010,000
Less deduction for existing depreciation.....	9,075,000
Present fair and reasonable value.....	69,950,000

My inventory and appraisal covering all the property of plaintiff in the State of New Jersey including that used or useful in the rendition of interstate telephone service appears in 16 volumes consisting of over 1,100 pages giving full details of all the items entering into the appraisal and the values attributed to such items. That valuation in detail was presented to the Board of Public Utility Commissioners in the rate investigation which terminated with the order of December 31, 1924, complained of in this suit. I was a witness in said proceeding and said volumes were introduced as ex-[fol. 76] hibits in my testimony. Based upon this appraisal and all other facts as set forth above, it is my opinion that the fair and reasonable value of the entire property of the plaintiff used or useful in and devoted to the rendition of telephone service both intrastate and interstate in the State of New Jersey, as of July 1st, 1924, was 91,263,480 dollars, which may be summarized as follows:

Plant and equipment.....	\$88,920,551
Working cash	1,807,281
Materials and supplies	764,619
Going Value	11,782,000
Less deduction for existing depreciation.....	12,010,971
Fair and reasonable value.....	91,263,480

Taking into consideration the gross additions to and retirements of property of plaintiff from and after June 30, 1924, to and including December 31, 1924, it is my opinion that the cost of reproduction as of December 31, 1924, of plaintiff's entire property in the State of New Jersey used or useful in and devoted to the rendition of telephone service, both intrastate and interstate, is not less than \$110,000,000, and the fair and reasonable value of said property is not less than \$97,000,000, and that as of said date the reproduction cost of plaintiff's property used or useful in and devoted exclusively to intrastate telephone service is \$84,400,000, and the fair and reasonable value of same is \$74,600,000.

It is my opinion that the average fair and reasonable value of the entire property of the plaintiff in the State of New Jersey used or useful in and devoted to the rendition of telephone service, both intrastate and interstate, for the periods stated below was—

1922.....	\$73,000,000
1923.....	\$81,000,000
1924.....	\$91,000,000

and of the property devoted to intrastate service exclusively the average fair and reasonable value was, as follows:

1922.....	\$55,000,000
1923.....	\$62,000,000
1924.....	\$70,000,000

I am familiar with the figures appearing in the attached affidavit of Mr. H. C. Carpenter, verified January 29th, 1925, setting forth the estimated additions to the property in the State of New Jersey during the year 1925 and taking such figures into consideration, it is my opinion that the average fair and reasonable value of plaintiff's property in the State of New Jersey used or useful in and devoted to the rendition of telephone service both intrastate and interstate for the year 1925 will be 102,000,000 dollars and of that part of said property devoted exclusively to the rendition of intrastate telephone service the said average fair and reasonable value will be 79,000,000 dollars.

So far as the figures stated in the above affidavit relate to intrastate property only the apportionment as between intrastate and interstate property is made on the basis shown in the annexed affidavit of Andrew Sangster verified the 29th day of January, 1925.

(Sd.) George W. Whittemore.

Subscribed and sworn to before me this 29th day of January, 1925. (Sd.) Edward C. Ryder, Notary Public. Notary Public for Queens County. Certificate Filed in New York County. New York County Clerk's No. 321. Register's No. 5274. My Commission Expires March 30, 1925. (Seal.)

[fol. 77]

IN UNITED STATES DISTRICT COURT

[Title omitted]

AFFIDAVIT OF HARLAND A. TRAX—Filed Jun. 25, 1925

STATE OF NEW YORK,

County of New York, ss:

Harland A. Trax, being duly sworn, deposes and says:

I am Chief Accountant of plaintiff Company and reside at No. 99 Joralemon Street in the Borough of Brooklyn, County of Kings, City and State of New York.

I was graduated from Bucknell University in 1901 with the degree of Bachelor of Philosophy and in 1903 received the degree of Master of Arts from said University for special work in economics. I first entered the telephone business in 1904 with The Central District Telephone Company in Pittsburgh, Pennsylvania, this corporation being one of the Associate Bell Telephone Companies, and served in various capacities with that Company and with The Bell Telephone

Company of Pennsylvania until June 1914 when I became associated with the New York Telephone Company, the plaintiff in this suit, becoming its Chief Accountant, which office I have held continuously since that time, except for a period during the World War when I held the commissions respectively of First Lieutenant and Captain in the United States Army.

As Chief Accountant I have entire charge of the Accounting Department in the absence of the General Auditor, to which officer I report directly.

I am thoroughly familiar with the books of account and records of the plaintiff Company relating to the costs of plaintiff's property and to its revenues and expenses. Plaintiff's accounts are and have been since January 1, 1913, kept in accordance with the Accounting System and regulations prescribed by the Interstate Commerce Commission adopted and approved by the Board of Public Utility Commissioners of the State of New Jersey. As so kept said accounts do not separate the portions of plaintiff's investment used in its service between intrastate and interstate business nor do they separate the revenues and expenses relating to said classes of business.

For the purpose of this affidavit the basis of apportionment shown in the attached affidavit of Andrew Sangster, verified the 29th day of January, 1925, is adopted. The average cost of plaintiff's property as hereinafter stated is made up from three general classes of accounts prescribed by the said regulations of the Interstate Commerce Commission; to wit, fixed capital, construction work in progress, materials and supplies. Fixed capital designates and includes the items making up the cost of the plant and equipment in service and intangible capital; construction work in progress designates and includes the items making up the cost of like plant in course of construction and intended to be put into service as soon as completed; materials and supplies designate and include items of material necessarily required in connection with the operation, maintenance and extension of the plant. The amounts in these accounts are changing continually and the following statements are, in each instance, based upon the average in each of these accounts for the period covered by the statement in question. Additions to plant of plaintiff are constantly being built and are treated as construction work in progress until the plant is put into service. They then become items of fixed capital and are transferred to the accounts included in that classification.

The statements as to cost hereinafter set forth contain nothing on account of franchises or of the item known as going concern value. In said costs proper deductions have been made for all plant retired and the figures shown are net figures and represent the costs only of plant now used or useful by plaintiff Company in the rendition of its intrastate telephone service in the State of New Jersey.

In the following tables, in which average fair and reasonable values are set up, those values are taken from the attached affidavit of George W. Whittemore, the Valuation Engineer of plaintiff Company, verified January 29th, 1925.

Year 1922

The net return earned by the plaintiff through its telephone rates for the rendition of its intrastate telephone service in the State of New Jersey during the year 1922 amounted to 0.97% of the cost of its property used or useful in and devoted solely to the rendition of said service, including necessary working cash, and to not more than 0.76% of the average fair and reasonable value of such property, the average fair and reasonable value thereof and the result of operations for said year are as follows:

[fol. 79] New York Telephone Company
Property, Revenues and Expenses Relating to Intrastate Service, New
Jersey Division

Year 1922

Average Cost of Property:		Intrastate service
*Average Fixed Capital	\$38,930,263.99	
Average Construction Work in Progress	2,828,592.56	
Average Working Cash	1,121,017.77	
Average Materials and Supplies	452,741.66	
Total	43,332,615.98	
Average fair and reasonable value not less than ..	55,000,000.00	
Telephone Revenues:		
Exchange Service	9,085,117.90	
Toll Service	2,727,947.40	
Miscellaneous	185,279.72	
Total Telephone Revenues	11,998,345.02	
Telephone Expenses:		
Current Maintenance	1,998,761.85	
Depreciation and Amortization	2,213,18.44	
Traffic	3,637,946.56	
Commercial	1,370,631.52	
General and Miscellaneous	348,019.78	
Uncollectible Operating Revenues	40,065.92	
Taxes	1,213,562.29	
Rent Expense and Deductions	191,024.47	
Miscellaneous Deductions	48,388.50	
License Contract Expense	517,694.11	
Total Telephone Expenses	11,578,813.44	
Net Telephone Earnings	419,531.58	
Percent Net Earnings of cost .....	.97%	
Percent Net Earnings of fair and reasonable value ..	.76%	

*Excluding interest during construction.

Year 1923

The net return earned by the plaintiff through its telephone rates for the rendition of its intrastate telephone service in the State of New Jersey during the year 1923 amounted to 1.35% of the cost of its property used or useful in and devoted solely to the rendition of said service, including necessary working cash, and to not more than 1.10% of the average fair and reasonable value of such property in said year. Said cost of said property, the average fair and reasonable value thereof and the result of operations for said year are as follows:

[fol. 80]

New York Telephone Company

Property, Revenues and Expenses Relating to Intrastate Service,
New Jersey Division

Year 1923

Average Cost of Property:	Intrastate Service
*Average Fixed Capital.....	\$45,765,928.21
Average Construction Work in Progress.....	2,767,267.10
Average Working Cash.....	1,232,604.42
Average Materials and Supplies.....	518,567.09
Total	50,314,366.82
Average fair and reasonable value not less than....	62,000,000.00
Telephone Revenues:	
Exchange Service.....	10,648,241.31
Toll Service.....	2,963,588.95
Miscellaneous	185,460.54
Total Telephone Revenues.....	13,797,290.80
Telephone Expenses:	
Current Maintenance.....	2,308,216.32
Depreciation and Amortization.....	2,399,312.43
Traffic	4,143,481.67
Commercial	1,510,338.41
General and Miscellaneous.....	419,114.50
Uncollectible Operating Revenues.....	56,891.44
Taxes	1,426,535.89
Rent Expense and Deductions.....	211,203.70
Miscellaneous Deductions.....	45,094.81
License Contract Expense.....	595,475.23
Total Telephone Expenses.....	13,115,664.40
Net Telephone Earnings.....	681,626.40
Per Cent Net Earnings of Cost.....	1.35%
Per Cent Net Earnings of fair and reasonable value.	1.10%

*Excluding Interest During Construction.

Year 1924

The net return earned by the plaintiff through its telephone rates for the rendition of its intrastate telephone service in the State of New Jersey during the year 1924 amounted to 0.50% of the cost of its property used or useful in and devoted solely to the rendition of said service, including necessary working cash, and to not more than 0.42% of the average fair and reasonable value of such property in said year. Said cost of said property, the average fair and reasonable value thereof and the result of operations for said year are as follows:

[fol. 81] New York Telephone Company	
Property, Revenues and Expenses Relating to Intrastate Service, New Jersey Division	
Year 1924	
Average Cost of Property:	Intrastate Service
*Average Fixed Capital.....	\$54,689,883.63
Average Construction Work in Progress.....	2,589,573.94
Average Working Cash.....	1,420,956.69
Average Materials and Supplies.....	588,064.18
Total	59,288,478.44
Average fair and reasonable value not less than....	70,000,000.00
Telephone Revenues:	
Exchange Service.....	12,003,458.33
Toll Service.....	3,291,086.14
Miscellaneous	202,273.73
Total Telephone Revenues.....	15,496,818.23
Telephone Expenses:	
Current Maintenance.....	2,873,559.99
Depreciation and Amortization.....	2,805,712.01
Traffic	4,764,849.96
Commercial	1,787,186.90
General and Miscellaneous.....	469,164.88
Uncollectible Operating Revenues.....	98,187.47
Taxes	1,440,907.80
Rent Expense and Deductions.....	240,798.13
Miscellaneous Deductions.....	53,064.37
License Contract Expense.....	668,166.17
Total Telephone Expenses.....	15,201,597.68
Net Telephone Earnings.....	295,220.55
Per Cent Net Earnings of cost.....	.50%
Per Cent Net Earnings of fair and reasonable value.....	.42%

*Excluding Interest During Construction.

Estimate for Year 1925

Assuming that the existing rates continue in effect during the whole of the year 1925, and adopting the estimate of the average cost of the property of the plaintiff used or useful and devoted solely to the rendition of its intrastate telephone service in the State of New Jersey, including working cash, during the year 1925, as stated in the annexed affidavit of Henry C. Carpenter, verified January 29th, 1925, and adopting the estimate of revenues and expenses for the year 1925 stated in said affidavit of Henry C. Carpenter, and making an apportionment of such estimates between intrastate and interstate business on the basis shown in the annexed affidavit of Andrew Sangster, verified January 29th, 1925 and adopting the estimated average fair and reasonable value of the said property for said year as stated in the annexed affidavit of George W. Whittimore verified January 29th, 1925, the net return which will be earned by the plaintiff through its telephone rates for the rendition of its intrastate telephone service in the State of New Jersey during said year will amount to 0.46% of the average cost of said property during such year, and to not more than 0.40% of the estimated fair and reasonable value of such property during said year. The said estimated average cost of said property and the said estimated fair and reasonable value thereof during said year and the said estimated revenues and expenses for said year are as follows:

[fol. 82]

New York Telephone Company

Property, Revenues and Expenses Relating to Intrastate Service,
New Jersey Division

Year 1925, Estimated

Average Cost of Property:		Intrastate service
*Average Fixed Capital		\$64,643,059.99
Average Construction Work in Progress		2,413,981.81
Average Working Cash		1,573,521.90
Average Materials and Supplies		654,731.92
Total		69,285,295.62
Average fair and reasonable value not less than ..		<u>79,000,000.00</u>
Telephone Revenues:		
Telephone Expenses:		Intrastate service
Exchange Service		13,281,000.00
Toll Service		3,534,478.00
Miscellaneous		233,495.79
Total Telephone Revenues		17,048,973.79

*Excluding Interest During Construction.

	Intrastate Service
Current Maintenance	2,914,410.21
Depreciation and Amortization	3,359,639.85
Traffic	5,258,955.64
Commercial	1,960,550.95
General and Miscellaneous	469,447.47
Uncollectible Operating Revenues	96,499.31
Taxes	1,622,808.29
Rent Expense and Deductions	237,896.69
Miscellaneous Deductions	44,377.58
License Contract Expense	736,131.02
Total Telephone Expenses	16,730,747.01
Net Telephone Earnings	318,226.78
Percent Net Earnings of cost .....	.46%
Percent Net Earnings of fair and reasonable value .....	.40%

The amounts by which the net telephone earnings derived by plaintiff from its intrastate telephone business in the State of New Jersey have fallen short of a return of 8% upon the above-stated fair and reasonable value of its property used or useful in and devoted to the rendition of said intrastate telephone service are as stated below for the respective periods indicated:

Year 1922	\$3,980,468
" 1923	4,278,374
" 1924	5,304,779

The amounts by which the net telephone earnings derived by plaintiff from its intrastate telephone business in the State of New Jersey have fallen short of a return of 8% upon the above-stated cost of its property used or useful in and devoted to the rendition of said intrastate telephone service are as stated below for the respective periods indicated:

Year 1922	\$3,047,078
" 1923	3,343,523
" 1924	4,447,858

As stated above in this affidavit, the books and accounts of plaintiff do not separate the property used in rendering service as between intrastate and interstate business, nor do they separate the revenues and expenses relating to these classes of service. In the investigation by the Board of Public Utility Commissioners of New Jersey, which preceded the Order complained of in this suit, the figures presented were as shown on the books of plaintiff and comprised the property, revenues and expenses in said State attributable to both intrastate and interstate business. I have shown on the tables following, the figures taken from plaintiff's books showing the average [fol. 83] cost of plaintiff's property in the State of New Jersey used or useful in and devoted to the rendition of its telephone service both intrastate and interstate, also revenues and expenses of plain-



Microcard Editions

An Indian Head Company

A Division of Information Handling Services

CARD 2

tiff attributable to its entire operations in said State, these figures being shown for the years 1922, 1923 and 1924 and an estimate for the year 1925. In connection therewith I have also shown the figures for the fair and reasonable value of said entire property in the State of New Jersey, which said figures were obtained from the attached affidavit of Mr. George W. Whittemore, Appraisal Engineer of plaintiff, verified January 29th, 1925.

I have also shown an estimate for the year 1925 using the same data as in the estimate for 1925 for intrastate business only hereinbefore set forth, with the exception that the property, revenues and expenses attributable to interstate business have not been excluded from said estimate.

New York Telephone Company

Total Property, Revenues and Expenses, New Jersey Division Year 1922

Average Cost of Property:	Total
*Average Fixed Capital	\$51,786,002.73
Average Construction Work in Progress	3,339,048.04
Average Working Cash	1,423,583.20
Average Materials and Supplies	602,285.00
Total	57,150,918.97
Average fair and reasonable value not less than.	73,000,000.00
Telephone Revenues:	
Exchange Service	9,085,117.90
Toll Service	8,553,760.13
Miscellaneous	232,257.03
Total Telephone Revenues	17,871,135.06
Telephone Expenses:	
Current Maintenance	2,388,224.26
Depreciation and Amortization	2,777,631.73
Traffic	4,376,530.70
Commercial	1,840,820.28
General and Miscellaneous	442,531.51
Uncollectible Operating Revenues	59,823.58
Taxes	1,767,789.76
Rent Expense and Deductions	232,089.31
Miscellaneous Deductions	65,705.73
License Contract Expense	753,226.07
Total Telephone Expenses	14,704,372.93
Net Telephone Earnings	3,166,762.13
Percent Net Earnings of cost	5.54%
Percent Net Earnings of fair and reasonable value	4.34%

*Excluding Interest During Construction.

[fol. 84]

New York Telephone Company

Total Property, Revenues and Expenses, New Jersey Division

Year 1923

Average Cost of Property:

Total

*Averaged Fixed Capital	\$59,841,428.38
Average Construction Work in Progress.....	3,284,457.73
Average Working Cash.....	1,602,588.00
Average Materials and Supplies.....	678,018.00

Total	65,406,492.11
-------------	---------------

Average fair and reasonable value not less than..	81,000,000.00
---	---------------

Telephone Revenues:

Exchange Service	10,618,241.31
Toll Service	9,322,275.48
Miscellaneous	254,823.59

Total Telephone Revenues.....	20,225,340.38
-------------------------------	---------------

Telephone Expenses:

Current Maintenance	2,735,508.27
Depreciation and Amortization.....	2,992,920.31
Traffic	4,989,281.00
Commercial	2,055,628.68
General and Miscellaneous	529,297.55
Uncollectible Operating Revenues.....	83,468.01
Taxes	2,092,435.68
Rent Expense and Deductions.....	255,438.29
Miscellaneous Deductions	61,979.94
License Contract Expense.....	851,331.71

Total Telephone Expenses	16,647,289.44
--------------------------------	---------------

Net Telephone Earnings.....	3,578,050.94
-----------------------------	--------------

Percent Net Earnings of cost.....	5.47%
Percent Net Earnings of fair and reasonable value	4.42%

*Excluding interest during Construction.

New York Telephone Company

Total Property, Revenues and Expenses, New Jersey Division

Year 1924

Average Cost of Property:		Total
*Average Fixed Capital.....	\$70,587,953.60	
Average Construction Work in Progress.....	3,106,424.59	
Average Working Cash.....	1,793,953.20	
Average Materials and Supplies.....	758,980.20	
Total	\$76,247,311.59	
Average fair and reasonable value not less than....	\$91,000,000.00	
Telephone Revenues:		
Exchange Service	\$12,003,458.36	
Toll Service	10,324,528.08	
Miscellaneous	273,294.13	
Total Telephone Revenues.....	\$22,601,280.57	
Telephone Expenses:		
Current Maintenance	\$3,419,260.24	
Depreciation and Amortization	3,469,133.51	
Traffic	5,802,613.78	
Commercial	2,421,136.94	
General and Miscellaneous.....	591,094.63	
Uncollectible Operating Revenues.....	143,336.63	
Taxes	2,035,387.58	
Rent Expenses and Deductions.....	293,148.41	
Miscellaneous Deductions	65,858.22	
License Contract Expense.....	951,042.28	
Total Telephone Expenses.....	\$19,192,012.31	
Net Telephone Earnings.....	\$3,409,268.26	
Percent Net Earning of cost.....	4.47%	
Percent Net Earnings of fair and reasonable value	3.75%	

*Excluding interest during Construction.

[fol. 85]

New York Telephone Company

Total Property, Revenues and Expenses, New Jersey Division

Year 1925 (Estimated)

Average Cost of Property:		Total
*Average Fixed Capital.....		\$82,758,648.12
Average Construction Work in Progress.....		2,925,059.39
Average Working Cash.....		1,981,200.00
Average Materials and Supplies.....		838,250.00
Total		88,503,107.51
Average fair and reasonable value not less than....		102,000,000.00
Telephone Revenues:		
Exchange Service		13,281,000.00
Toll Service		11,113,000.00
Miscellaneous		316,269.00
Total Telephone Revenues.....		24,710,269.00
Telephone Expenses:		
Current Maintenance		3,453,400.00
Depreciation and Amortization.....		4,128,000.00
Traffic		6,104,435.00
Commercial		2,657,000.00
General and Miscellaneous.....		589,166.00
Uncollectible Operating Revenues.....		140,000.00
Taxes		2,269,691.00
Rent Expense and Deductions.....		325,744.00
Miscellaneous Deductions		55,813.00
License Contract Expense.....		1,041,695.00
Total Telephone Expenses.....		21,065,974.00
Net Telephone Earnings		3,644,295.00
Percent Net Earnings of cost.....		4.12%
Percent Net Earnings of fair and reasonable value		3.57%

The amounts by which the net earnings for the years above shown have fallen short of a return of 8% upon the fair and reasonable value and cost respectively of the property used or useful and

*Excluding interest during Construction.

devoted to the rendition of telephone service in the State of New Jersey, both intrastate and interstate, are as follows:

Year	Less than 8% on fair value	Less than 8% on cost
1922.....	\$2,673,238	\$1,405,311
1923.....	2,901,949	1,654,468
1924.....	3,870,732	2,690,517

In the order complained of herein the said Board of Public Utility Commissioners found the fair value of the entire property of plaintiff in the State of New Jersey to be \$76,370,000 as of June 30th, 1924. The net earnings of plaintiff as shown in the above table for the year 1924 would amount to 4.46% of said value as found by said Board.

The cost as of December 31, 1924, of plaintiff's property in the State of New Jersey used or useful in and devoted to the rendition of telephone service, both intrastate and interstate, was \$82,899,597, and of plaintiff's property used or useful in and devoted exclusively to the rendition of intrastate telephone service was \$64,452,242 as of said date.

(Sd.) Harland A. Trax.

Subscribed and sworn to before me this 29th day of January, 1925. (Sd.) Edward C. Ryder, Notary Public. Notary Public for Queens County. Certificate Filed in New York County. New York County Clerk's No. 321. Register's No. 5274. My Commission Expires March 30, 1925. (Seal.)

[fol. 86] IN UNITED STATES DISTRICT COURT

[Title omitted]

AFFIDAVIT OF ANDREW SANGSTER—Filed Jan. 25, 1925

On Separation of Property, Revenues and Expenses Between Intra-
state and Interstate

STATE OF NEW YORK,
County of New York, ss:

Andrew Sangster, being duly sworn, deposes and says:

I reside at 188 Fairmount Avenue, Chatham, New Jersey; I am a consulting accountant practising under the firm name of Andrew Sangster & Company, at 25 Broadway, New York City, and specializing in matters pertaining to public utility accounting; my said firm has been employed by various State Public Utilities Commissions, municipalities, and public utility corporations to advise and assist in valuations and rate cases and to perform accounting services in connection therewith.

In the year 1914 I was appointed Chief Accountant of the Valuation Bureau of the Public Utilities Commission of the District of Columbia, which Commission was then engaged in a valuation of all the public utility properties operating within its jurisdiction, including the Chesapeake & Potomac Telephone Company, of Washington, D. C., and I held that position for a period of about three years. In 1914 and 1915 I was employed by a Joint Legislative Committee of the State of New York appointed to investigate telephone rates and service in the City of New York and in the State of New York, in which employment I made an examination and report on the accounts of the plaintiff, New York Telephone Company. In the year 1917 I was employed by the City of Birmingham, Alabama, to investigate the accounts of the Southern Bell Telephone and Telegraph Company with reference to its property, revenues and expenses in the Cities of Birmingham and Bessemer, Alabama. In the year 1919 I was employed by the Chicago Telephone Company (now the Illinois Bell Telephone Company) to investigate and report upon its plant accounting methods for property located in the City of Chicago (Chicago Division).

In the year 1922 I was employed by the Cumberland Telephone & Telegraph Company to investigate the method used by that Company in the separation of its property, revenues and expenses in the State of Tennessee between its intrastate exchange and toll service and its interstate toll service and made affidavit as to the basis used, which affidavit was filed in the suit brought by said Company against [fol. 87] the Railroad and Public Utilities Commission of the State of Tennessee in the District Court of the United States for the Middle District of Tennessee, Nashville Division. In the year 1923 I participated in making a separation of the revenues and expenses of the Illinois Bell Telephone Company in the City of Chicago (Chicago Division) between its intrastate exchange and toll service and its interstate toll service, and made affidavit as to the basis used, which affidavit was filed in the suit brought by said Company against the Illinois Commerce Commission of the State of Illinois and the Attorney General of the State of Illinois in the District Court of the United States for the Northern District of Illinois, Eastern Division.

In the year 1922 I participated in making a separation of the property, revenues and expenses of the plaintiff, New York Telephone Company, in the State of New York, between its intrastate exchange and toll service and its interstate toll service and made an affidavit as to the basis used for said separation, which affidavit was filed in the suit brought by the plaintiff in March, 1922, against the Public Service Commission of the State of New York and the Attorney General of the State of New York in the District Court of the United States, Southern District of New York (In Equity No. 23-252).

In the year 1924 I participated in the making of a separation of property, revenues and expenses of the plaintiff, New York Telephone Company, in the State of New York, between its intrastate exchange and toll service and its interstate toll service, and made an affidavit as to the basis used for said separation, which affidavit was filed in the suit brought by the plaintiff in April, 1924, against the

Public Service Commission of the State of New York, and the Attorney General of the State of New York in the District Court of the United States, Southern District of New York (In Equity No. 29-126).

I am familiar with the Uniform System of Accounts prescribed by the Interstate Commerce Commission, effective January 1, 1923, for telephone companies throughout the United States subject to the Act to Regulate Commerce, which System of Accounts has been approved and adopted by the Board of Public Utility Commissioners of the State of New Jersey. I am also familiar with the accounting methods and practices of the plaintiff, New York Telephone Company, the accounts of which are kept in accordance with the rules and regulations contained in the said prescribed System of Accounts.

The property of the plaintiff, used or useful in rendering telephone service in the State of New Jersey and devoted exclusively to that service, is used in the performance of two classes of service; one of these classes of service being the interstate toll service furnished by said plaintiff and the other being the general intrastate telephone service furnished by said plaintiff. Said Uniform System of Accounts prescribed by the Interstate Commerce Commission does not require the complete separation of the accounts of telephone companies so as to show separately the accounts relating to the interstate toll business and the accounts relating to the general intrastate telephone business; where portions of the said property of the plaintiff are not used exclusively for one of these classes of service, but are used in both of them and where the revenue and expense accounts do not relate solely to one class of service, but include both of them, it has been necessary to make separations in order to de- [fol. 88] termine the cost and the value of plaintiff's property devoted exclusively to its intrastate telephone service within the State of New Jersey and to determine the revenues and expenses properly attributable to such service. The fundamental basis adopted in the making of such separation and shown in this affidavit is the extent of the use of the property and operating services in each of the said two classes of plaintiff's telephone service.

A complete list of the accounts covering the plaintiff's property, revenues and expenses relating to its telephone operations is set out below, and in connection with each account it is indicated whether it has been necessary to apportion it in order to make the separation between the plaintiff's intrastate and interstate business, and where the account is apportioned, the basis of the apportionment is set out.

Account No.	Property
201. Organization.	
204. Other Intangible Capital.	

These accounts are apportioned in the ratio of the book costs of plant in service devoted to interstate toll service and to all intrastate service respectively to the book cost of total plant in service.

211. Land.

Account
No.

212. Buildings.

The portion of these accounts representing space used for division headquarters is apportioned between interstate and intrastate service on the basis of the ratio of total current maintenance, traffic and commercial expenses charged to interstate toll service and to all intrastate service respectively. The remainder of these accounts is apportioned between interstate toll service and all intrastate service on the basis of the ratio of book cost of central office equipment devoted to interstate toll service and to all intrastate service respectively to the book cost of total central office equipment.

220. Central Office Equipment.

The book cost of central office equipment used for toll service exclusively was determined, and is apportioned between interstate and intrastate toll service on the basis of its use for the two classes of service respectively.

The cost of message registers was determined and is assigned to intrastate service exclusively.

The remaining central office equipment is apportioned between interstate toll service and all intrastate service on the basis of its use for the respective classes of service.

230. Station Equipment.

This account is apportioned on the basis of its use for interstate toll service and for all intrastate service respectively.

207. Right of Way.

241. Exchange Pole Lines.

242. Exchange Aerial Cable.

243. Exchange Aerial Wire.

244. Exchange Underground Conduit.

245. Exchange Underground Cable.

246. Exchange Submarine Cable.

251. Toll Pole Lines.

[fol. 89] 252. Toll Aerial Cable.

253. Toll Aerial Wire.

254. Toll Underground Conduit.

255. Toll Underground Cable.

256. Toll Submarine Cable.

The amount included in these accounts covering interoffice exchange trunk plant used for intrastate service exclusively was deducted and is assigned to intrastate service. The amount covering long distance trunk plant used for interstate service exclusively was deducted and is assigned to interstate service. The balance remaining representing plant used in common for interstate toll service and for all intrastate service is apportioned on the basis of its use for the respective classes of service.

Account
No.

104. Construction Work in Progress.

Each class of plant included in this account is apportioned between interstate toll service and all intrastate service on the basis of the separation of the corresponding class of plant in service.

260. General Equipment.

This account is apportioned between interstate toll service and all intrastate service on the basis of the ratio of book cost of plant in service devoted to the respective classes of service to total plant in service.

Revenues

500. Subscribers' Station Revenues.

501. Public Pay Station Revenues.

502. Miscellaneous Exchange Service Revenues.

These accounts relate to intrastate service exclusively.

510. Message Tolls.

512. Leased Toll Lines.

514. Telegraph Service on Toll Lines.

These accounts are apportioned between interstate toll service and intrastate toll service on the basis of studies made from the accounting records of the Company.

515. Minor Rents of Toll Plant.

This account is assigned to intrastate service exclusively.

521. Telegraph Commissions.

This account relates to intrastate service exclusively.

523. Advertising and Directory Revenue.

This account is apportioned between interstate toll service and all intrastate service on the basis used to apportion Account 649 Directory Expenses, as explained hereinafter under "Expenses".

524. Rents from Other Operating Property.

311. Miscellaneous Rent Revenues.

320. Rent Expense.

322. Nonoperating Taxes.

These accounts are apportioned between interstate toll service and all intrastate service on the basis of the ratio of book cost of buildings devoted to each of these two classes of service [fol. 90] respectively.

525. Other Miscellaneous Revenues.

The portion of this account representing compensation for services of private branch exchange operators is apportioned between interstate toll service and all intrastate service on the basis used to apportion Account 624 Operators' Wages.

The remaining portion of this account is assigned to intrastate service exclusively.

401. Miscellaneous Additions to Surplus.

The portion of this account relating to operations is assigned to intrastate service exclusively.

Account
No.

Expenses

601. Supervision of Maintenance.

This account is apportioned between interstate toll service and all intrastate service on the basis of the ratio of total repairs of plant, included in Accounts 602 to 607 inclusive, attributed to each of these two classes of service respectively.

602. Repairs of Aerial Plant.

Repairs of Pole Lines, Aerial Cable, and Aerial Wire are apportioned on the basis of the book costs of the respective classes of plant devoted to interstate toll service and to all intrastate service respectively. Repairs of aerial Right of Way are apportioned on the basis of the book costs of total aerial plant except Right of Way devoted to interstate toll service and to all intrastate service respectively.

603. Repairs of Underground Plant.

Repairs of Underground Conduit, Underground Cable, and Submarine Cable are apportioned on the basis of the book costs of the respective classes of plant devoted to interstate toll service and to all intrastate service respectively. Repairs of underground Right of Way are apportioned on the basis of the book costs of total underground plant except Right of Way devoted to interstate toll service and to all intrastate service respectively.

604. Repairs of Central Office Equipment.

This account is apportioned on the basis of the book cost of central office equipment devoted to interstate toll service and to all intrastate service respectively.

605. Repairs of Station Equipment.

607. Station Removals and Changes.

These accounts are apportioned on the basis of the book cost of station equipment devoted to interstate toll service and to all intrastate service respectively.

606. Repairs of Buildings and Grounds.

This account is apportioned on the basis of the book cost of land and buildings devoted to interstate toll service and to all intrastate service respectively.

608. Depreciation.

340. Amortization of Landed Capital.

The portion of these accounts representing depreciation on each class of property is apportioned on the basis of the book cost of the corresponding class of property devoted to interstate

[fol. 91] toll service and to all intrastate service respectively.

621. Traffic Superintendence.

622. Service Inspection.

623. Clerical Operating Wages.

624. Operators' Wages.

626. Rest and Lunch Rooms.

627. Operators' Schooling.

629. Central Office Stationery and Printing.

631. Miscellaneous Central Office Expenses.

**Account
No.**

632. Pay Station Expenses.

633. Other Traffic Expenses.

These accounts are apportioned on the basis of the amount of work performed by switchboard operators in handling interstate toll messages and all intrastate messages respectively.

628. Transmission Power.

This account is apportioned on the basis of the amount of power used for interstate toll service and for all intrastate service respectively.

640-10. General Commercial Administration.

This account is apportioned on the basis of the total direct commercial expenses, included in Accounts 640-30 to 649 inclusive, attributed to interstate toll service and to all intrastate service respectively.

640-30. Local Commercial Administration.

642. Advertising.

643. Canvassing.

These accounts are apportioned on the basis of the ratio of interstate toll revenues and all intrastate telephone revenues respectively to the total of such revenues.

644. Sub-Licensee Relations.

This account is apportioned on the basis of the ratio of interstate toll revenues and intrastate toll revenues respectively to the total of such revenues.

646. Revenue Accounting.

This account is apportioned between intrastate exchange service and interstate and intrastate toll service on the basis of a study of the cost of work performed in revenue accounting offices attributable to each of these two classes of service respectively. The amount thus assigned to interstate and intrastate toll service is apportioned between these two classes of service in the ratio of the number of originating messages in each class respectively to the total of such messages.

647. Revenue Collecting.

This account is apportioned between intrastate exchange service and interstate and intrastate toll service in the ratio of exchange service revenues and toll service revenues respectively to the total of such revenues. The amount thus assigned to interstate and intrastate toll service is apportioned between these two classes of service in the ratio of the number of originating messages in each class respectively to the total of such messages.

648. Pay-Station Commissions.

This account is apportioned between intrastate exchange service and interstate and intrastate toll service on the basis of [fol. 92] the ratio of intrastate exchange revenue and interstate and intrastate toll revenue respectively, collected from public coin box telephones, to the total of such collections.

The amount thus assigned to interstate and intrastate toll service is apportioned between these two classes of service on the basis of the ratio of interstate toll revenues and intrastate toll revenues respectively to the total of such revenues.

649. Directory Expenses.

The portion of this account representing the cost of directories used for interstate service exclusively was determined and is assigned to interstate service. The portion representing the cost of directories used for intrastate service exclusively was determined and is assigned to intrastate service. The portion representing the cost of directories used jointly for interstate and intrastate service is apportioned on the basis of the use of such directories for each of these classes of service.

660. General Office Salaries.

663. General Office Supplies and Expenses.

667. General Law Expenses.

669. Accidents and Damages.

670. Law Expenses Connected with Damages.

671. Miscellaneous General Expenses.

690. General Expenses Charged Construction—Cr.

These accounts are apportioned between interstate toll service and all intrastate service on the basis of the arithmetic mean of the amounts assigned to each class of service by the application of the following two ratios:

(a) The ratio of total current maintenance, traffic and commercial expenses, attributed to interstate toll service and to all intrastate service respectively, to the total of such expenses;

(b) The ratio of book cost of plant and equipment in service attributed to interstate toll service and to all intrastate service respectively to the total plant and equipment in service.

668. Insurance.

This account is apportioned on the basis of the ratio of the book cost of insured property, i. e., buildings, central office equipment, and general equipment used for interstate toll service and for all intrastate service respectively.

694. Uncollectible Operating Revenues.

This account is apportioned on the basis of the ratio of the interstate toll revenues and all intrastate revenues respectfully to the total of such revenues.

605. Taxes Assignable to Operations.

Real estate taxes are apportioned on the basis of the ratio of book cost of land and buildings attributed to interstate toll service and to all intrastate service respectively to the total book cost of such property.

New Jersey tax on property other than land and buildings is apportioned on the basis of the ratio of book cost of plant and equipment in service, excluding land and buildings, attributed to interstate toll service and to all intrastate service

Account
No.

respectively. New Jersey franchise tax computed on gross receipts is apportioned on the basis of the ratio of interstate toll revenues and all intrastate revenues respectively subject to the tax.

[fol. 93] The Federal Capital Stock Tax is apportioned on the basis of the ratio of book cost of plant and equipment in service attributed to interstate toll service and to all intrastate service respectively to the book cost of total plant and equipment in service.

Federal Income Tax is apportioned on the basis of the ratio of net earnings, exclusive of Federal income tax, from interstate toll service and from all intrastate service respectively to the total of such net earnings.

331. Rent Deductions for Telephone Offices.

The portion of this account representing rentals paid for space used by each department. (Traffic, Plant, Commercial, and Revenue Accounting) is apportioned on the basis of the total expenses of the respective departments attributed to interstate toll service and to all intrastate service respectively.

332. Rent Deductions for Conduits, Poles, and Other Supports.

This account is apportioned on the basis of the use of the rented property for interstate toll service and for all intrastate service respectively.

334. Miscellaneous Rent Deductions.

This account is apportioned between interstate toll service and intrastate toll service on the basis of the use of toll lines for each of these classes of service respectively.

341. Miscellaneous Deductions from Income.

This account represents the Federal tax on uncollectible toll charges and is apportioned between interstate toll service and intrastate toll service on the basis of the ratio of toll revenues derived from interstate toll service and intrastate toll service respectively, to the total of such revenues.

414. Amortization Unprovided for Elsewhere.

This account is apportioned on the basis of the ratio of book cost of plant and equipment in service attributed to interstate toll service and to all intrastate service respectively to the book cost of total plant and equipment.

417. Other Deductions from Surplus.

The portion of this account relating to operations is assigned to intrastate exchange service exclusively.

527. Licensee Revenue—Dr. (License Contract Expense).

This account is apportioned on the basis of the ratio of interstate toll revenues and all intrastate revenues respectively, subject to the license payment, to the total of such revenues.

I have read the affidavit of Warland A. Trax made herein, verified the 29th day of January, 1925, showing the property, revenues

and expenses of the plaintiff relating to its intrastate telephone service in the State of New Jersey from 1922 to 1924, inclusive, and estimates for 1925 and the results of plaintiff's telephone operations therein set forth are determined upon the basis of separation described in this affidavit and I participated in the making of such separations. The results of plaintiff's telephone operations and estimates of operations so set forth in said affidavit of Harland A. Trax are in my opinion substantially accurate and correct.

(Sd.) Andrew Sangster.

Subscribed and sworn to before me this 29th day of January, 1925. (Sd.) Edward C. Ryder, Notary Public. Notary Public for Queens County. Certificate Filed in New York County. New York County Clerk's No. 321. Register's No. 5274. My Commission Expires March 30, 1925. (Seal.)

[fol. 94]

IN UNITED STATES DISTRICT COURT

[Title omitted]

AFFIDAVIT OF JESSE A. MOIR—Filed Jan. 25, 1925

STATE OF NEW YORK,
County of New York, ss:

Jesse A. Moir, being duly sworn, deposes and says:

I am Statistician of the New York Telephone Company, the plaintiff herein. I have been in the employ of said plaintiff for twenty years, being employed for the last fifteen years in the Accounting Department and for the last five years engaged in statistical work. The work of which I have charge as statistician includes the collection and analysis of statistical data directly and indirectly related to the telephone industry and the drawing of conclusions from such data that may be utilized by plaintiff in the transaction of its business. The chart attached hereto and identified as "J. A. M.-1" was prepared under my personal supervision and direction and based on information which I have personally checked and examined. The said chart is intended to show diagrammatically the trends of exchange revenues per station of the plaintiff company, of exchange and toll revenue combined per station, average wholesale commodity prices, general industrial wages in New Jersey, plaintiff's wages in the State of New Jersey and the scheduled maximum wages of plaintiff in the State of New Jersey between 1910 and 1925. The base to which the results shown by the chart are related is indicated by the line "00." The years are indicated by the figures at the bottom of the chart. For the years 1920 to 1924 inclusive a larger scale was adopted so that the results might be shown by months for those years. The figures on each side of the chart show the per cent. of

increase or decrease from the condition existing in 1910 indicated by the base line. Each of the curves upon the chart are designated by a legend appearing thereon. The curve showing the trend of average wholesale commodity prices is made up from the figures compiled and published by the United States Bureau of Labor Statistics. The curve showing the trend of industrial wages in New Jersey is made up from data compiled by the New Jersey State Department of Labor and the New York State Department of Labor. The curves showing the average wages, both as paid and as scheduled, and the per station revenues of the plaintiff company are made up from the records and accounts of that company. The basic data [fol. 95] from which the curves shown on Exhibit J. A. M.-1 are plotted are shown in detail on tables hereto annexed and marked "Exhibit J. A. M.-2." The curves on the chart have been constructed to show trends and do not in every case show the minor fluctuations indicated by the detailed statistics shown on Exhibit J. A. M.-2, such details not being significant in respect of such trend.

(Sd.) Jesse A. Moir.

Subscribed and sworn to before me this 29th day of January, 1925. (Sd.) Edward C. Ryder, Notary Public. Notary Public for Queens County. Certificate Filed in New York County. New York County Clerk's No. 321. Register's No. 5274. My Commission Expires March 30, 1925. (Seal.)

(Here follows Exhibit J. A. M. #1, marked side folio pages 96 and 97)

[fol. 98] EXHIBIT J. A. M. 2 TO AFFIDAVIT OF JESSE A. MOIR

Statistics Represented Diagrammatically by Chart on Exhibit J. A. M. 1 Supported and Supplemented by the following Tabular Statements:

- (1) "General Wages in New Jersey"
- (2) "New York Telephone Company—Wages—State of New Jersey"
- (3) "New York Telephone Company—Scheduled Maximum Wages—State of New Jersey"
- (4) "General Wholesale Commodity Prices"
- (5) "New York Telephone Company—Exchange and Toll Revenue per Station"
- (6) "New York Telephone Company—Exchange Revenue per Station"

General Wages in New Jersey

The figures in Column "A" for the years 1910 to 1918, inclusive, were obtained from the New Jersey State Department of Labor, and represent the average weekly earnings of male and female factory

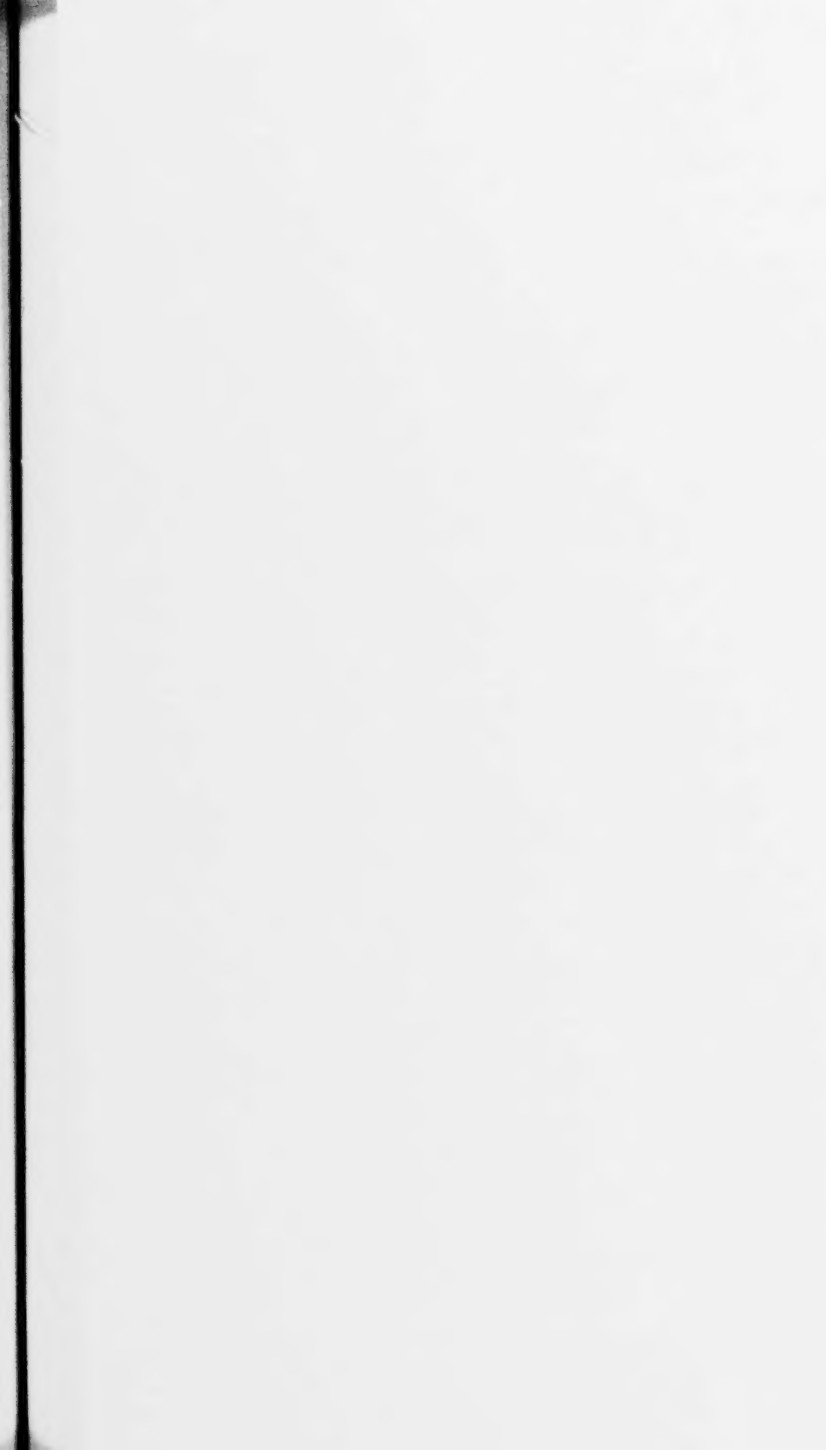
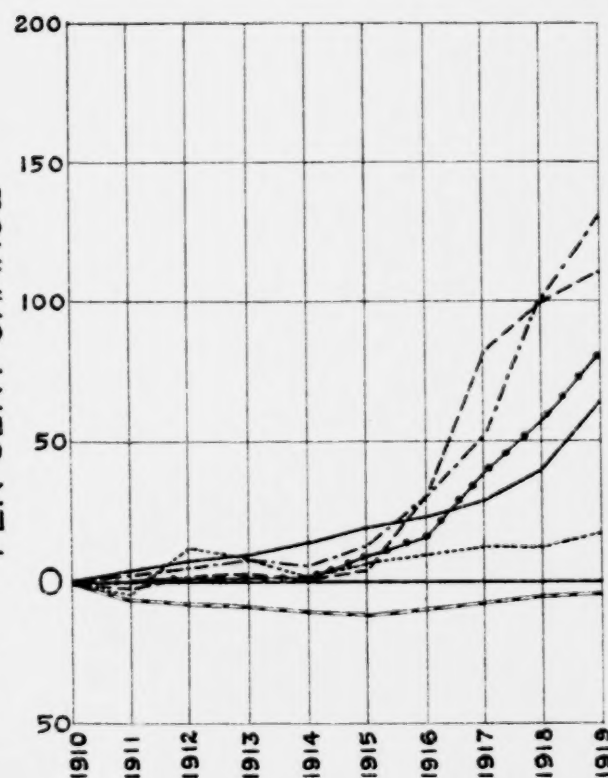


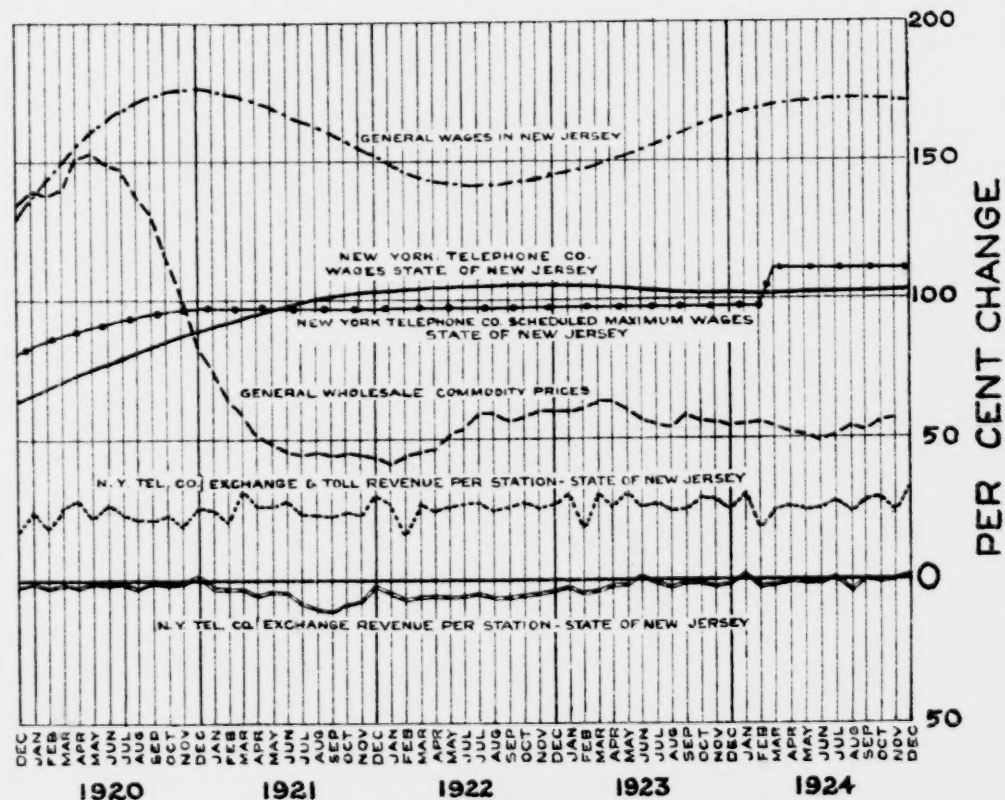
EXHIBIT J.A.M. i to affidavit of Jesse A. Moir.

COMPARISON OF TRENDS
WAGES, WHOLESALE COMMODITY PRICES,
AND AVERAGE EXCHANGE AND TOLL REVENUE PER STATION SINCE 1910



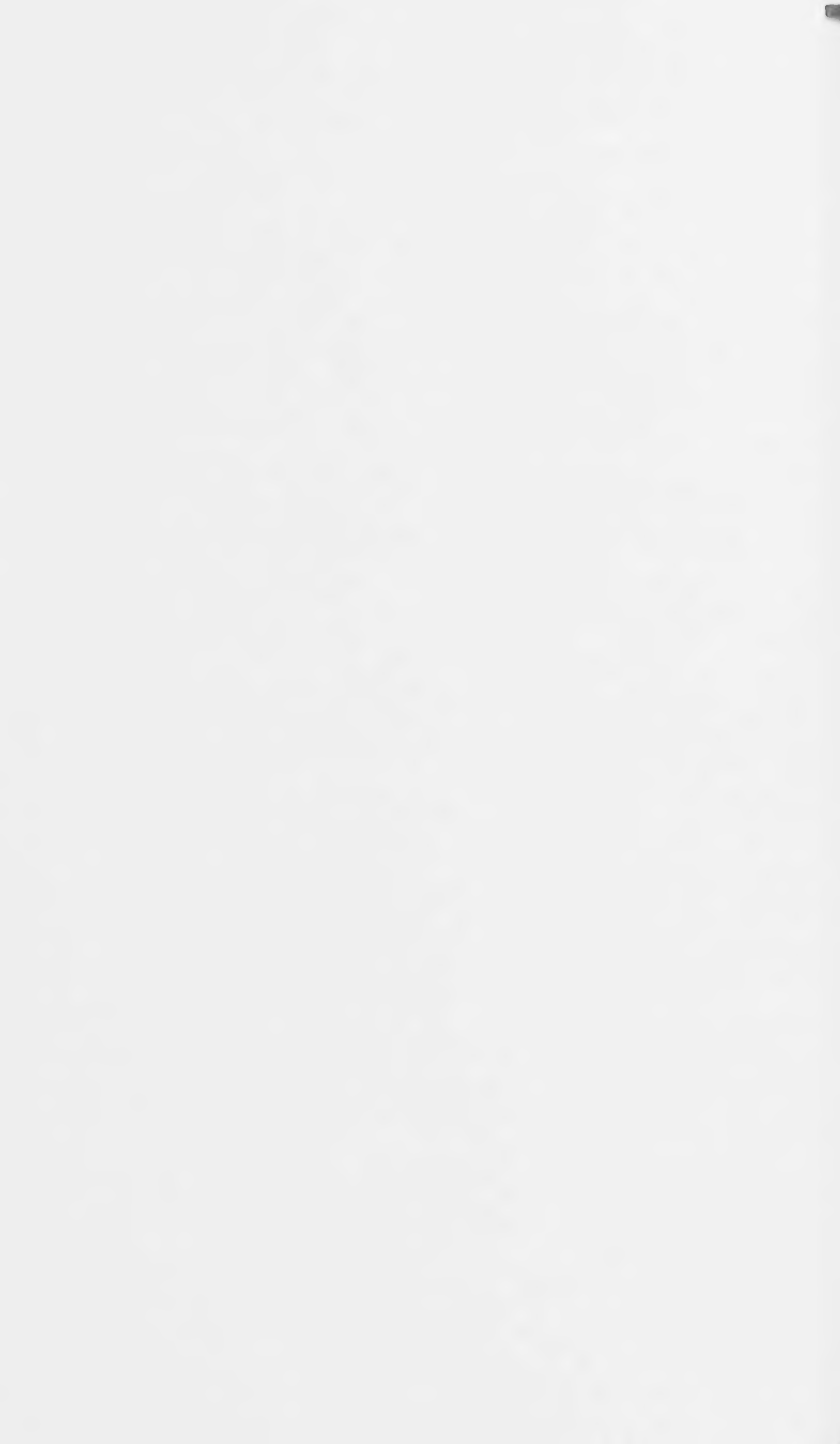
GENERAL WAGES IN NEW JERSEY - TREND OF AVERAGE EARNINGS PER EMPLOYEE IN REPRESENTATIVE MANUFACTURING INDUSTRIES IN NEW JERSEY TO 1918; IN NEW YORK STATE SINCE 1919.

GENERAL WHOLESALE COMMODITY PRICES - TREND OF AVERAGE WHOLESALE COMMODITY PRICES FOR THE UNITED STATES.



NEW YORK TELEPHONE COMPANY WAGES - TREND OF AVERAGE AUTHORIZED RATES OF PAY PER EMPLOYEE OF NEW YORK TELEPHONE CO.

NEW YORK TELEPHONE COMPANY SCHEDULED MAXIMUM WAGES - TREND OF AVERAGE SCHEDULED MAXIMUM RATES OF PAY OF NEW YORK TELEPHONE CO. (PLANT WORKING FORCES AND TELEPHONE OPERATORS).



workers in the State of New Jersey. In 1918 the compilation of statistics of this nature was discontinued by the State Department of Labor which was, and has been, the sole agency for the compiling of such data. Inasmuch as working conditions in New York State and the State of New Jersey for comparable classes of workers are more or less uniform, due to the geographic location of the state and the similar types of industries operating within these states, data on general wages for New York State, for the years from 1918 to 1924, inclusive, have been assumed to indicate the general trend of wages in the State of New Jersey since 1918.

The figures in Column "B" for the years 1918 and 1919, and for each of the months from January 1920, to December 1924, inclusive, are from various issues of "The Industrial Bulletin" published by the New York State Department of Labor, and represent the average weekly earnings in representative industrial establishments in New York State.

In Column "C" the data of Columns "A" and "B" have been combined into a continuous series based upon the year 1910, by making a projection of general wages in New Jersey from 1918 to December 1924, inclusive, based upon the trend of wages of factory workers in New York State over the same period.

The figures in Column "D" represent per cent increase or decrease in weekly earnings for each year or month as compared with 1910. The curve for the period from January 1920, to December 1924, as shown on the chart, has been smoothed to represent the general trend of the data.

Year	Column A	Column B	Column C	Column D
1910.....	\$10.23	.....	\$10.23	.....
1911.....	10.47	.....	10.47	+ 2.4
1912.....	10.71	.....	10.71	+ 4.7
1913.....	11.01	.....	11.01	+ 7.6
1914.....	10.84	.....	10.84	+ 6.0
1915.....	11.51	.....	11.51	+ 12.5
1916.....	13.22	.....	13.22	+ 29.2
1917.....	15.46	.....	15.46	+ 51.1
1918.....	20.45	\$20.35	20.45	+ 99.9
1919.....	.....	23.50	23.62	+ 130.9
1920, January.....	.....	26.52	26.65	+160.5
February.....	.....	26.47	26.60	+1 0.0
March.....	.....	27.87	28.01	+173.8
April.....	.....	27.80	27.94	+173.1
May.....	.....	28.45	28.59	+179.5
June.....	.....	28.77	28.91	+182.6
July.....	.....	28.49	28.63	+179.9
August.....	.....	28.71	28.85	+182.0
September.....	.....	28.73	28.87	+182.2
October.....	.....	28.93	29.07	+184.2
November.....	.....	28.70	28.84	+181.9
December.....	.....	28.35	28.49	+178.5

Year		Column A	Column B	Column C	Column D
1921,	January .....	.....	27.61	27.75	+171.3
	February .....	.....	26.77	26.90	+163.0
	March .....	.....	26.97	27.10	+164.9
	April .....	.....	26.20	26.33	+157.4
	May .....	.....	25.86	25.99	+154.1
[fol. 99]					
	June .....	.....	25.71	25.84	+152.6
	July .....	.....	25.26	25.38	+148.1
	August .....	.....	25.43	25.55	+149.8
	September .....	.....	25.07	25.19	+146.2
	October .....	.....	24.53	24.65	+141.0
	November .....	.....	24.32	24.44	+138.9
	December .....	.....	24.91	25.03	+144.7
1922,	January .....	.....	24.43	24.55	+140.0
	February .....	.....	24.17	24.29	+137.4
	March .....	.....	24.57	24.69	+141.4
	April .....	.....	24.15	24.27	+137.2
	May .....	.....	24.59	24.71	+141.6
	June .....	.....	24.91	25.03	+144.7
	July .....	.....	24.77	24.89	+143.3
	August .....	.....	25.10	25.22	+146.5
	September .....	.....	25.71	25.83	+152.5
	October .....	.....	25.61	25.74	+151.6
	November .....	.....	26.04	26.17	+155.8
	December .....	.....	26.39	26.52	+159.2
1923,	January .....	.....	26.21	26.34	+157.5
	February .....	.....	25.87	26.00	+154.2
	March .....	.....	26.92	27.05	+164.4
	April .....	.....	27.00	27.13	+165.2
	May .....	.....	27.63	27.76	+171.4
	June .....	.....	27.87	28.01	+173.8
	July .....	.....	27.54	27.67	+170.5
	August .....	.....	27.12	27.25	+163.4
	September .....	.....	27.41	27.54	+169.2
	October .....	.....	27.72	27.86	+172.3
	November .....	.....	27.64	27.78	+171.6
	December .....	.....	27.99	28.13	+175.0
1924,	January .....	.....	27.81	27.95	+173.2
	February .....	.....	27.73	27.87	+172.4
	March .....	.....	28.16	28.30	+176.6
	April .....	.....	27.70	27.84	+172.1
	May .....	.....	27.56	27.70	+170.8
	June .....	.....	27.21	27.34	+167.3
	July .....	.....	27.06	27.19	+165.8
	August .....	.....	27.49	27.53	+169.1
	September .....	.....	28.05	28.19	+175.6
	October .....	.....	27.53	27.66	+170.4
	November .....	.....	27.66	27.80	+171.8
	December .....	.....	28.26	28.40	+177.6

New York Telephone Company—Wages—State of New Jersey

Column "A" shows the average weekly rate of pay for all telephone employees in the State of New Jersey for each year from 1910 to 1919, inclusive, and for each of the months from January 1920 to December 1924, inclusive, as shown by the records of the New York Telephone Company.

Column "B" shows the per cent increase or decrease for each year or month as compared with 1910. The curve for the period from January 1920 through December 1924, as shown on the chart, has been smoothed to represent the general trend of the data.

Year	Column A	Column B	Year	Column A	Column B
1910	\$12.70	.....	1922, January ...	\$26.02	+104.92
1911	13.34	+ 5.03	February ..	25.93	+104.23
1912	13.98	+ 10.42	March	25.96	+103.95
1913	14.26	+ 12.34	April	25.78	+103.02
1914	14.79	+ 16.50	May	25.71	+102.46
1915	15.47	+ 21.85	June	25.74	+102.72
1916	15.89	+ 25.51	July	25.73	+102.68
1917	16.32	+ 28.55	August ...	25.71	+102.46
1918	17.58	+ 38.49	September .	25.71	+102.48
1919	20.82	+ 63.94	October ...	25.77	+102.93
			November .	25.82	+103.39
			December .	25.90	+103.98
1920, January ...	22.60	+ 79.18	1923, January ..	25.96	+104.48
February ..	23.49	+ 85.48	February ..	25.93	+104.25
March	24.27	+ 91.64	March	25.83	+103.40
April	24.67	+ 94.81	April	25.65	+102.02
May	25.09	+ 98.11	May	25.48	+100.70
June	25.08	+ 98.07	June	25.41	+100.10
July	24.90	+ 96.63	July	25.37	+ 99.80
August	24.88	+ 96.49	August ...	25.75	+ 99.67
September .	25.05	+ 97.86	September .	25.38	+ 99.88
October ...	25.09	+ 98.11	October ...	25.41	+100.09
November .	25.04	+ 97.73	November .	25.41	+100.09
December .	25.06	+ 97.95	December .	25.44	+100.37
1921, January ...	25.28	+ 99.11	1924, January ...	25.34	+100.11
February ..	25.49	+100.78	February ..	25.22	+ 99.17
March	25.73	+102.67	March	25.24	+ 99.34
April	25.91	+104.03	April	25.33	+100.06
May	25.87	+103.73	May	25.39	+100.75
June	25.86	+103.70	June	25.49	+101.32
July	25.96	+104.48	July	25.58	+102.02
August	26.04	+105.08	August ...	25.69	+101.87
September .	26.06	+105.22	September .	25.81	+103.82
October ...	26.03	+105.05	October ...	25.95	+104.97
November .	26.07	+105.32	November .	26.08	+105.96
December .	26.09	+105.46	December .	26.15	+106.50

[fol. 100] New York Telephone Company—Scheduled Maximum Wages—State of New Jersey

The figures in Column "A" represent the average maximum weekly rates of pay for the Plant Working Forces and Telephone Operators of the New York Telephone Company located in the State

of New Jersey for each year from 1910 to 1924, inclusive, as shown by the wage schedules of the New York Telephone Company.

Column "B" shows the per cent increase or decrease for each year as compared with 1910. The curve for the period from 1920 through 1924 has been smoothed to represent the general trend of the data.

Year	Column A	Column B
1910.....	\$20.71	.....
1911.....	20.71	.....
1912.....	20.92	+ 1.01
1913.....	20.92	+ 1.01
1914.....	20.92	+ 1.01
1915.....	22.45	+ 8.40
1916.....	23.97	+ 15.74
1917.....	28.53	+ 37.75
1918.....	32.39	+ 56.40
1919.....	37.63	+ 81.70
1920.....	40.89	+ 97.44
1921.....	40.89	+ 97.44
1922.....	40.89	+ 97.44
1923.....	40.89	+ 97.44
1924.....	43.67	+110.86

General Wholesale Commodity Prices

The figures in Column "A" for the years 1910 to 1913, inclusive, are from Bulletin No. 173 of the United States Bureau of Labor Statistics, "Index Numbers of Wholesale Prices in the United States and Foreign Countries," page 126, and represent, for "All Commodities," a weighted annual index of wholesale prices for the United States based on average prices during the period 1890 to 1899.

The figures for the years 1913 to 1919, inclusive, and for each of the months from January, 1920, to November, 1924, inclusive, in column "B," are from various issues of the Monthly Labor Review published by the U. S. Bureau of Labor Statistics, and represent substantially the same index as for 1910 to 1913, continued beyond 1913 but based on average prices in the year 1913 instead of on average prices during the period 1890 to 1899.

In Column "C," the data of Columns "A" and "B" have been combined into a continuous series based upon the year 1910.

The figures in Column "D" represent the per cent increase or decrease in the index number for each year or month, as compared with 1910.

Year	Column A	Column B	Column C	Column D
1910.....	131.6	...	100	...
1911.....	129.2	...	98	— 2
1912.....	133.6	...	102	+ 2
1913.....	135.2	100	103	+ 3
1914.....	...	98	101	+ 1

Year	Column A	Column B	Column C	Column D
1915.....		101	101	+ 4
1916.....		127	130	+ 30
1917.....		177	182	+ 82
1918.....		194	199	+ 99
[fol. 101] 1919.....		205	212	+ 112

Year	Column A	Column B	Column C	Column D
1920, January		233	239	+ 139
February		232	238	+ 138
March		234	240	+ 140
April		245	252	+ 152
May		247	254	+ 154
June		243	250	+ 150
July		241	248	+ 148
August		231	237	+ 137
September ...		226	232	+ 132
October		211	217	+ 117
November ...		196	201	+ 101
December ...		179	184	+ 84
1921, January		170	175	+ 75
February		160	164	+ 64
March		155	159	+ 59
April		148	152	+ 52
May		145	149	+ 49
June		142	146	+ 46
July		141	145	+ 45
August		142	146	+ 46
September ...		141	145	+ 45
October		142	146	+ 46
November ...		141	145	+ 45
December ...		140	144	+ 44
1922, January		138	142	+ 42
February		141	145	+ 45
March		142	146	+ 46
April		143	147	+ 47
May		148	152	+ 52
June		150	154	+ 54
July		155	159	+ 59
August		155	159	+ 59
September ...		153	157	+ 57
October		154	158	+ 58
November ...		156	160	+ 60
December ...		156	160	+ 60

Year	Column A	Column B	Column C	Column D
1923, January		156	160	+ 60
February		157	161	+ 61
March		159	163	+ 63
April		159	163	+ 63
May		159	160	+ 66
June		153	157	+ 57
July		151	155	+ 55
August		150	154	+ 54
September		154	158	+ 58
October		153	157	+ 57
November		152	156	+ 56
December		151	155	+ 55
1924, January		151	155	+ 55
February		152	156	+ 56
March		150	154	+ 54
April		148	152	+ 52
May		147	151	+ 51
June		145	149	+ 49
July		147	151	+ 51
August		150	154	+ 54
September		149	153	+ 53
October		152	155	+ 56
November		153	157	+ 57

New York Telephone Company—Exchange and Toll Revenue per Station

Column "A" shows the average yearly exchange and toll revenue per station for the State of New Jersey for each year from 1910 to 1919, inclusive, and for each of the months from January, 1920, to December, 1924, inclusive, as shown by the accounts and records of the New York Telephone Company.

Column "B" shows the per cent increase or decrease over 1910.

Year	Column A	Column B	Year	Column A	Column B
1910	\$51.40	—	1922, January	\$65.18	+ 26.81
1911	49.33	— 4.03	February ..	60.08	+ 16.89
1912	57.51	+ 11.89	March	65.28	+ 27.00
1913	55.61	+ 8.19	April	63.77	+ 24.07
1914	52.39	+ 1.93	May	64.68	+ 25.84
1915	54.63	+ 6.28	June	65.04	+ 26.54
1916	56.11	+ 9.16	July	65.69	+ 26.63
1917	57.89	+ 12.63	August	64.06	+ 24.63
1918	57.72	+ 12.30	September ..	64.94	+ 26.34
1919	60.64	+ 17.98	October	65.52	+ 27.47
			November ..	64.32	+ 25.14
			December ..	65.16	+ 26.77

Year	Column A	Column B	Year	Column A	Column B
1920, January ...	64.14	+ 24.79	1923, January ...	67.08	+ 30.51
February ..	60.88	+ 18.44	February ..	60.72	+ 18.13
March	64.50	+ 25.49	March	66.96	+ 30.27
April	66.00	+ 28.40	April	64.44	+ 25.37
May	63.00	+ 22.57	May	67.08	+ 30.51
June	65.28	+ 27.00	June	64.68	+ 25.84
July	63.48	+ 23.50	July	65.28	+ 27.00
August	62.64	+ 21.87	August	63.84	+ 24.20
September ..	62.47	+ 21.54	September ..	64.20	+ 24.90
October	63.48	+ 23.50	October	66.24	+ 28.87
November ..	61.14	+ 18.95	November ..	63.12	+ 22.80
December ..	64.68	+ 25.84	December ..	63.96	+ 24.44
1921, January ...	64.20	+ 24.90	1924, January	67.20	+ 30.74
February ..	62.00	+ 20.62	February ..	60.60	+ 17.90
March	67.68	+ 31.67	March	63.84	+ 24.20
April	65.16	+ 26.77	April	64.44	+ 25.37
May	65.16	+ 26.77	May	63.96	+ 24.44
June	65.83	+ 28.07	June	64.32	+ 25.14
July	63.48	+ 23.50	July	65.04	+ 27.70
August	63.42	+ 23.39	August	63.48	+ 23.50
September ..	63.28	+ 23.11	September ..	65.64	+ 27.70
October	63.71	+ 23.95	October	66.24	+ 28.87
November ..	63.20	+ 22.96	November ..	63.48	+ 23.50
December ..	66.95	+ 30.25	December ..	67.56	+ 31.44

[fol. 102] New York Telephone Company—Exchange Revenue per Station

Column "A" shows the average yearly exchange revenue per station for the State of New Jersey for each year from 1910 to 1919, inclusive, and for each of the months from January, 1920, to December, 1924 inclusive, as shown by the accounts and records of the New York Telephone Company.

Column "B" shows the per cent increase or decrease over 1910.

Year	Column A	Column B	Year	Column A	Column B
1910	\$34.95	—	1922, January ...	\$33.60	— 3.86
1911	33.00	— 5.58	February ..	32.76	— 6.27
1912	32.34	— 7.47	March	33.00	— 5.58
1913	32.06	— 8.27	April	33.12	— 5.24
1914	31.44	— 10.04	May	33.00	— 5.58
1915	31.10	— 11.02	June	33.12	— 5.24
1916	31.78	— 9.07	July	33.48	— 4.21
1917	32.53	— 6.92	August	32.88	— 5.92
1918	33.33	— 4.64	September ..	32.88	— 5.92
1919	33.39	— 4.46	October	33.36	— 4.55
			November ..	33.48	— 4.21
			December ..	33.72	— 3.52
1920, January ...	34.80	— .43	1923, January ...	34.32	— 1.80
February ..	34.20	— 2.15	February ..	33.48	— 4.21
March	34.68	— .77	March	33.84	— 3.18
April	34.44	— 1.46	April	34.44	— 1.46
May	34.80	— .43	May	34.56	— 1.12
June	34.56	— 1.12	June	35.16	+ .60
July	34.68	— .77	July	34.92	— .09
August	34.20	— 2.15	August	34.20	— 2.15
September ..	34.80	— .43	September ..	34.80	— .43
October	34.68	— .77	October	34.80	— .43
November ..	34.80	— .43	November ..	34.44	— 1.46
December ..	35.64	+ 1.97	December ..	35.40	+ 1.29

Year	Column A	Column B	Year	Column A	Column B
1921, January ...	34.44	— 1.46	1924, January ...	35.64	+ 1.97
February ..	34.08	— 2.49	February ..	34.32	— 1.80
March	34.08	— 2.49	March	34.56	— 1.12
April	33.48	— 4.21	April	34.80	— .43
May	33.72	— 3.52	May	34.68	— .77
June	33.60	— 3.86	June	34.68	— .77
July	32.16	— 7.98	July	35.04	+ .26
August	31.80	— 9.61	August	33.84	— 3.18
September ..	31.20	— 10.73	September .	34.92	— .69
October	32.16	— 7.98	October	34.80	— .43
November ..	32.52	— 6.95	November ..	34.92	— .69
December ..	34.32	— 1.80	December ..	35.52	+ 1.63

[fol. 103]

IN UNITED STATES DISTRICT COURT

[Title omitted]

AFFIDAVIT OF HARRY M. ADDINSELL—Filed Jan. 25, 1925

STATE OF NEW YORK,

County of New York, ss:

Harry M. Addinsell, being duly sworn, deposes and says:

I reside at 29 East 64th Street, New York City, and am an investment banker. I am a director of Harris, Forbes & Company, 56 William Street, New York City, and have been with that investment house for eighteen years continuously with the exception of two years during which time I was in the World War. The said house is a member of the Investment Bankers Association and I was formerly a Chairman of the Public Utility Securities Committee of that Association.

Harris, Forbes & Company deals exclusively in investment securities of the classes offered to what are known in banking circles as the conservative investor and it therefore confines its purchases and sales of securities to those which it considers to be conservative investments and is, and for many years has been, one of the largest houses handling public utility securities. It is the practice of my said house to make an investigation of the operations of any public utility before it deals in the securities of such utility; when a proposal is made to it to handle such securities it first makes a preliminary investigation of the facts and figures relating to the company generally in order to determine whether or not there is a safe basis for the bonds or other securities which it is asked to handle, and if that matter is determined satisfactorily the investigation is continued by having an engineering examination made by competent engineers and accounting examinations made by expert accountants.

Harris, Forbes & Company and its predecessors, N. W. Harris & Co., have been in business for about forty-two years and during that period have had occasion to make extensive investigations into the

operations, properties, earnings and securities of a great many electric, gas, telephone, street railway, water and other public utilities.

It is my opinion that a public utility such as the plaintiff should not be restricted to earning an annual net return of less than 8% (after providing for depreciation) upon the fair and reasonable value of its property used or useful in the rendition of its service in order to place its securities upon a parity with other investments [fol. 104] competing for funds in the market. It should be borne in mind that the rate of return under discussion is merely permissive, and not guaranteed. In other words it is a maximum limit to earnings under the most favorable conditions and does not protect the company against the vicissitudes of general business, or its specific business.

In order to make the securities of a public utility salable, it is necessary that public confidence in such securities be established and maintained. The investors must have reasonable assurance of the integrity of the investment and the safety of their money, and must be afforded a return at least equal to the returns which they could obtain through other available investments of similar desirability.

The cost to public utilities of borrowed money, where the loans are adequately secured and where there is fixed obligation to return the money borrowed at a definite date, is obviously less than the return necessary to induce the investment of funds that are to be invested at the risk of the business.

The cost of borrowed money to public utilities fluctuates with market conditions and the size, credit and standing of the company seeking such money. During the immediate post-war period it was not unusual for a public utility to be obliged to pay as high as 10% for short term loans and long term loans cost the public utility companies on the average over 7%. At present the cost of long term loans to utilities averages around 5¾%, only a very few of the largest companies with the highest credit are able to obtain such loans at a slightly lower figure, and the vast majority of companies are obliged to pay a higher figure.

Prudence and conservatism dictate that only a proportion of the capital requirements of such corporations should be raised by the sale of bonds or other loans. It is fundamental that public utilities which expect to continue permanently in business and which are required continuously to increase their investments in order to meet the public service requirements imposed upon them must have a market for their stocks, and their stocks are not salable to investors unless it can be demonstrated that the company offering such stocks is earning and will continue to earn at least a reasonable return upon the value of its property devoted to the public use. There is active competition among utility corporations, industries and other businesses for the surplus funds which are at any time available for new investments, and plaintiff, like the others, is compelled to meet this competition and to offer inducements to investors equal to those offered by others at the same time.

(Sd.) Harry M. Addinsell.

Subscribed and sworn to before me this 29th day of January, 1925. (Sd.) Lincoln Jones. Notary Public, Kings Co., No. 31. Cert. Filed in N. Y. Co. No. 63. Kings Co. Register No. 6033. N. Y. Co. Register No. 6060. (Seal.)

[fol. 105] IN UNITED STATES DISTRICT COURT

[Title omitted]

AFFIDAVIT OF WILLIAM HENRY BLOOD, JR.—Filed Jan. 25, 1925

STATE OF NEW YORK,
County of New York, ss:

William Henry Blood, Jr., being duly sworn, deposes and says:

I reside in Wellesley, Massachusetts. I was educated as an electrical engineer at the Massachusetts Institute of Technology in Boston. I am now and have been for about thirty years connected with Stone & Webster, Incorporated, of Boston, New York and Chicago. My experience embraces engineering, constructing, managing, and financing public utilities of all kinds and during the past fifteen years I have given special attention to the appraisal of properties and reports on their methods of management and financing, largely for bankers and for presentation to commissions and courts. In the course of such work I have been responsible for the examination of some 700 public utility properties and have supervised appraisals of such properties having an aggregate value of over five and a half billion dollars, included among which properties were a number of telephone properties. In the course of my said work I have become generally familiar with telephone properties, their original costs and with the costs of reproduction thereof, and with the general matters of operation and management.

Going Concern Value

I consider that in determining the reproduction cost of any going property, including a telephone property, it is necessary to add to the cost of constructing the physical property, the cost of establishing the business and putting the property into successful operating condition. When the property has been developed into a going concern a value is added to the value of the physical plant.

It is a well-known fact that anyone would pay more for a property with an established business and operating organization and a plant which has been tuned up and coördinated as an efficient working unit than he would for a dead physical plant without connected customers and a trained operating organization.

The amount to be added to the value of physical property for going concern value or going value is one which varies with different enterprises and among individual cases in the same class of business.

In establishing a telephone business it is necessary to train operatives, to build up a maintenance organization, to obtain subscribers, and to do numerous other things which cost money and [fol. 103] bring no immediate return. When this has been done a substantial value has been added to that of the physical plant. There is no rule or formula by which this going value can be computed with any degree of accuracy but those who have had experience in determining it have found that it is best expressed in terms of percentage of the cost of the property. It is difficult to determine the exact percentage to apply in any given case but there are limits within which such percentage must reasonably fall.

In my experience in appraising public utility properties and in estimating the reproduction cost of the physical plant and also the going concern value, I have found that the percentage rate that the going concern value bears to the physical plant varies from a minimum of ten per cent. to a maximum of thirty per cent. in normal cases.

In my entire experience, covering over thirty years, I do not recall a single instance where the cost of establishing the "going concern" condition was less than 10% of the cost of the physical property, where there was sufficient data available to determine the matter, and this experience includes the investigation of several hundred public utility properties. In the great majority of cases which I have investigated I found the going concern value to be about 15% when the company had a well-established business and an efficient operating organization.

From all of the foregoing I consider that there must be included with the cost of reproduction new of the physical plant of the plaintiff, New York Telephone Company, a minimum of 10% thereof, in order to determine the total value of the entire property and give recognition to the going concern value. Such going concern value may be considerably in excess of the above figure but I am confining myself here to the statement of a minimum.

Fair Rate of Return

It is my opinion that a public utility corporation of proven earning capacity should at the present time receive a net annual return of not less than 8% upon the fair and reasonable value of its property used in rendering its service in order to place its securities on the market upon a parity with other investments competing for funds. It must have this amount if it is to live in competition with other enterprises which offer 8% or more to the investing public. It must have this amount to maintain its credit and to attract sufficient capital to pay for the cost of plant additions demanded by its rapidly increasing number of subscribers. Because of the number of public utilities in which my corporation of Stone & Webster, Incorporated, is interested, I keep familiar with the market rate of money for investment in first-class public utilities and I have known of actual sales recently of securities of a number of high-grade public utilities. Such sales showed that mortgage bonds followed by substantial

amounts of preferred and common stock sold on an average yield basis of from 6 to $6\frac{1}{2}\%$ (the rate to the company being higher than this after the payment of the banker's commission). Likewise, preferred stock of such corporations followed by a substantial amount of common stock has sold during such period on a basis to yield the investor from 7 to $8\frac{1}{2}\%$ (the corporation actually paying a higher rate after the payment of the banker's commission). Common stocks of public service corporations which are on an established dividend paying basis command a yield at the present time upon their selling price in the open market of from $7\frac{1}{2}\%$ to 9% .

[fol. 107] The above statements are, of course, statements of averages and where a public utility is earning very largely in excess of its dividend distribution the yield of the distributions may be lower than above, but I do not believe there are many cases where the rate of earnings will not bear a higher percentage than the above to the market value of the stock. Thus the average price that must be paid for money for investment in public utility corporations of a high grade is at least 8% upon the total value of the property. By using the rate of return upon the present-day market value of securities we obtain a method of comparison which eliminates all question of over-issue of securities.

To continue successfully any business a company must earn something in excess of what it pays out in interest and dividends. It must have a margin or factor of safety, this principle being well recognized by all bankers and investors.

The necessity of an annual return of at least 8% upon the fair and reasonable value of the property devoted to the public use is emphasized in the case of a public utility corporation like the plaintiff which requires constantly very large amounts of new capital in order to meet the requirements of its service, and such capital will not be attracted if it earns a return less than that rate.

Price Levels

By reason of the conditions growing out of the World War, there is a much higher level of prices at the present time than existed for a number of years prior to 1914. Based on actual construction cost records kept by Stone & Webster, Incorporated, aggregating a total expenditure of some \$500,000,000, charts have been made up showing year by year the general course of the prices of labor and materials entering into the construction of public utility plants. Such labor and materials are in many cases the same as the labor and materials entering into the construction of telephone plants and on the whole would bear a close relationship thereto.

These charts show that the high price of such labor and materials was reached in 1920. Immediately thereafter there was a sharp break in prices and the low price was reached about the latter part of 1921, since which time prices have been slightly but steadily increasing. As shown in the two cost charts hereto annexed, marked respectively "Exhibit W. H. B.-1" and "Exhibit W. H. B.-2" and made a part of this affidavit, such average costs for the year ending

EXHIBIT W.H.B. 1 to affidavit of Wm. H. Blood, Jr.

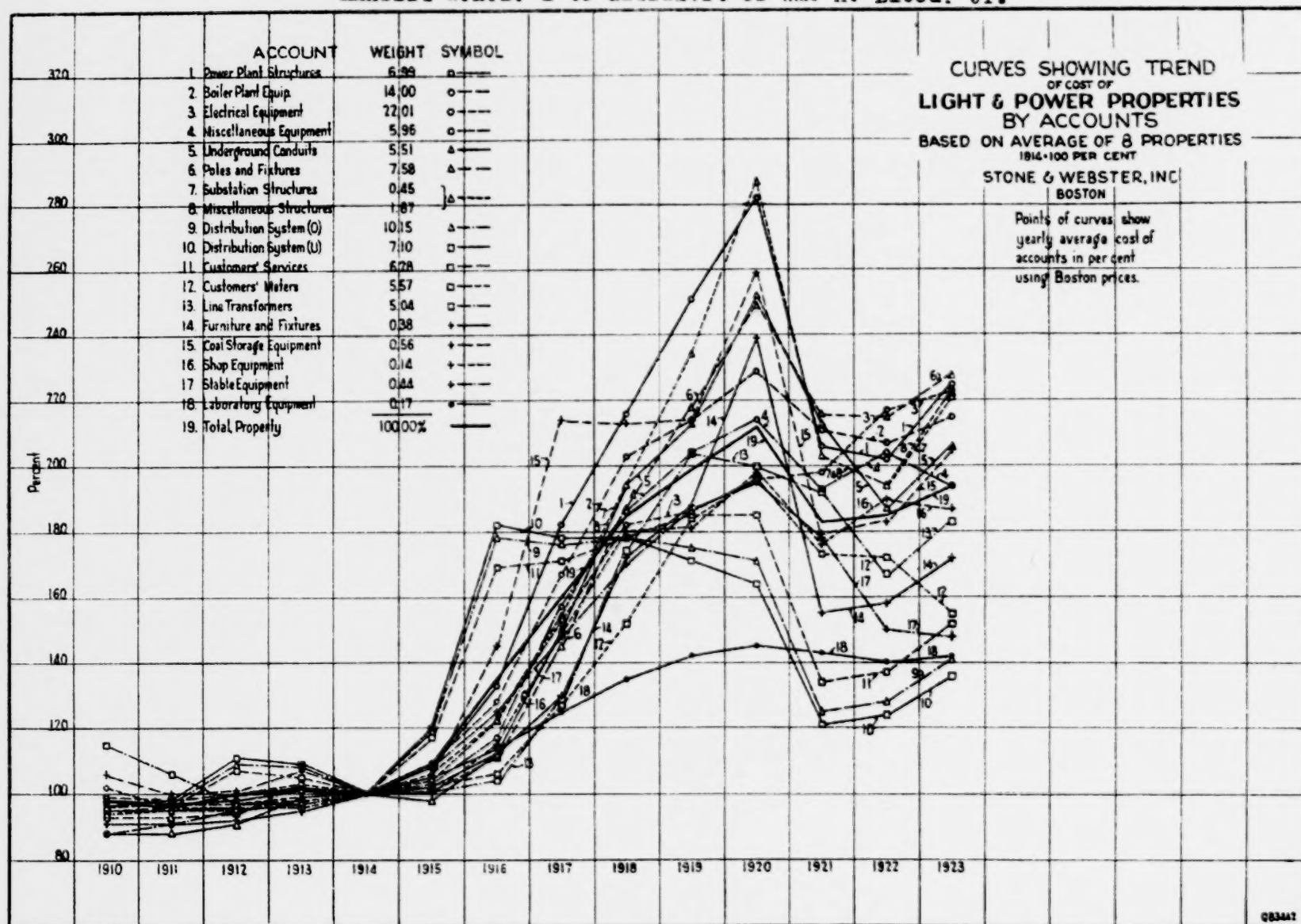
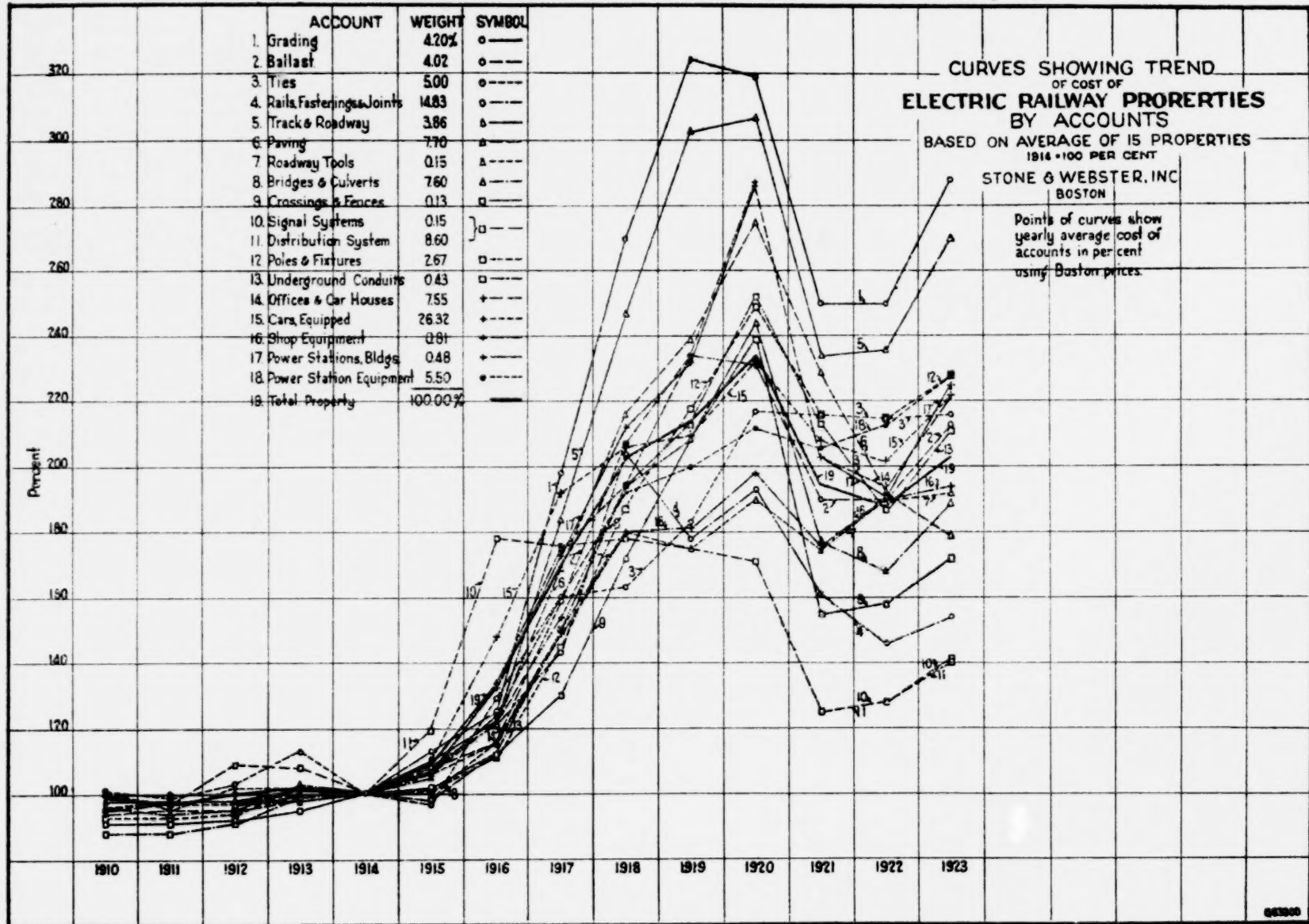


EXHIBIT W.H.B. 2 to affidavit of Wm. H. Blood, Jr.



December 31, 1923, were approximately double the costs for the year ending December 31, 1914. It is my opinion that the present general level of construction costs will be at least maintained for a substantial time to come, and I see nothing to indicate any general recession therefrom. I believe that it is the common opinion among informed persons that costs will not decrease, and this is borne out by the facts that for the past twelve months our clients have given us orders for construction work aggregating many millions of dollars. There will doubtless be fluctuations up and down by certain commodities but, with the general prosperity of the country, a steady increase in population, and a continuation of present business confidence, I can see no reason for any immediate prospect of a general recession of prices.

(Sd.) William Henry Blood, Jr.

Subscribed and sworn to before me this 26th day of January, 1925. (Sd.) Edward C. Ryder, Notary Public for Queens County. Certificate filed in New York County, New York County Clerk's No. 321. Register's No. 5274. My commission expires March 30, 1925. (Seal.)

(Here follow Exhibits W. H. B. 1 and 2, marked side folio pages 108-111)

[fol. 112] IN UNITED STATES DISTRICT COURT

[Title omitted]

AFFIDAVIT OF GEORGE W. WHITTEMORE ON DEPRECIATION—Filed
Jan. 25, 1925

STATE OF NEW YORK,

County of New York, ss:

George W. Whittemore, being duly sworn, deposes and says:

I am the George W. Whittemore who made the affidavit herein as to value verified January 29th, 1925.

The property used by the plaintiff in the rendition of its telephone service is classified under the system of accounts prescribed by the Interstate Commerce Commission, the so-called depreciable property being shown under the following items, with the account numbers as indicated:

- 212. Buildings.
- 221. Central Office Telephone Equipment.
- 222. Other Equipment of Central Offices.
- 231. Station Apparatus.
- 232. Station Installations.
- 233. Interior Block Wires.
- 234. Private Branch Exchanges.

- 235. Booths and Special Fittings.
- 241. Exchange Pole Lines.
- 242. Exchange Aerial Cable.
- 243. Exchange Aerial Wire.
- 244. Exchange Underground Conduit.
- 245. Exchange Underground Cable.
- 246. Exchange Submarine Cable.
- 251. Toll Poll Lines.
- 252. Toll Aerial Cable.
- 253. Toll Aerial Wire.
- 254. Toll Underground Conduit.
- 255. Toll Underground Cable.
- 256. Toll Submarine Cable.
- 261. Office Furniture and Fixtures.
- 262. General Shop Equipment.
- 263. General Store Equipment.
- 264. General Stable and Garage Equipment.
- 265. General Tools and Implements.

One of the fundamental facts involved in the conduct of the plaintiff's business and one duly recognized in the above mentioned accounting system is that in the rendition of its telephone service to its patrons plaintiff is concurrently using up its property of the kinds indicated in the foregoing classification.

An equally fundamental fact also recognized in said prescribed accounting system and duly provided for therein, is that the cost of such depreciable property, to the extent used up, is a part of the expense to the plaintiff of furnishing the service it renders; and one, therefore, which must be included with its expenses of other kinds, before the full expense of furnishing such service can properly be stated.

[fol. 113] For instance, a switchboard, which, under the above classification, would come under the head of central office telephone equipment, Account 221, will have a certain life during which it will be useful as a part of the Company's property then being employed in providing service. At the expiration of such useful life it will be discarded. Except for the salvage which may be received from this switchboard at the time it is discarded, its cost has been consumed in furnishing the service secured from it during its useful life. Such cost is one of the actual and unavoidable expenses incurred by the plaintiff in rendering such service.

Among the causes which end the useful life of any piece of depreciable property are physical decay, wear or tear, obsolescence, the fact that it becomes inadequate to meet the increasing volume of service required of it and because public necessity or demand calls for changes in the plant or because of storms, fires or other casualties.

In the ascertainment of the extent of loss suffered in any portion of the property during its useful life, due attention must be given to the matter of salvage, to which allusion above has already been made. When property is discarded, some salvage may be

realized from it. The amount of this salvage will obviously vary widely with the different classes of property. For instance, if, or when, it were necessary to remove an old pole line, probably the cost of taking it down would amount to more than the price for which the old poles could be sold. On the other hand, in the case of main underground cables the salvage, due to the amounts of lead and copper obtainable from such cables would be considerable; generally, much more than the cost of removal of such lead and copper cables. Under the aforesaid prescribed accounting system two terms, "salvage" and "net salvage," are used; the latter meaning the amount realized from the discarded property after deduction therefrom of costs incurred in its removal and subsequent disposition. In the foregoing case of poles, the "net salvage" would thus become a minus amount. In the case of main cables the net salvage would generally be a substantial percentage of its first cost in place.

For example: In the case of a pole line costing originally \$100,000 and requiring, say, \$10,000 over and above amounts realized for old material sold to effect its removal, a net salvage of minus \$10,000 or minus 10%, and consequently a loss in, or on account of, the depreciable property used up in rendition of service furnished during the useful life of said pole line of \$110,000 would result. In the case of the main underground cables above mentioned, were the original cost in place to have been \$100,000, the amount received for the lead and copper upon removal \$27,000, and the cost of removal \$2,000, then the "net" salvage would be \$25,000, or 25%; and the depreciable property consumed in supplying service during the life of such cables \$75,000.

To expenses incurred in rendering service such as the foregoing, the name "Depreciation of Plant and Equipment" is given in the aforesaid accounting system prescribed by the Interstate Commerce Commission.

Under such system the plaintiff is required to charge such expenses, as one of its several operating expenses, to Account 608, bearing title, "Depreciation of Plant and Equipment," (except certain minor items charged initially to certain clearing accounts) in equal periodical increments during the useful life of the property; in compliance with which requirements such charges are made month by month. At the time that this charge is made to this one [fol. 114] of operating expense accounts, 608, a corresponding credit is made to the account entitled "Reserve for Accrued Depreciation."

When a piece of property is discarded, this account "Reserve for Accrued Depreciation" is charged with the difference between the cost of this property and the net salvage recovered from it. At the same time the proper fixed capital account is reduced by the amount of the original cost of the property in question.

While the depreciation account is entitled "Reserve for Accrued Depreciation," no reserve in the sense of a fund set aside for this specific purpose is maintained. The moneys represented by these charges to operating expenses and credits to this account go into the

general funds of the plaintiff and find their way into property and plant owned by it; so that, as parts of its investment are retired they are replaced by other investments in a like amount and its capital is maintained unimpaired.

The treatment of this cost of rendering plaintiff's service, as given in the accounts, is the same as that given other cost items extending over a considerable period. For instance, in the cases of taxes covering a year, or interest covering a fixed period, or expenses of financing and bond discounts covering a number of years, the total is determined in advance and is then charged to the operating expenses in equal instalments monthly and credited monthly to the account entitled "166—Taxes Accrued," or "167—Accrued Liabilities Not Due," as the case may be.

The amounts representing these property losses involved in the rendition of service and which should, at any particular period be periodically charged to operating expenses, are, as prescribed in the accounting system, those then currently accruing in the several portions of such property according to the best estimates, based upon the plaintiff's experience and knowledge, then to be made of them.

The factors which determine, at any period, the amount which should, for any class of property, be periodically charged to operating expenses and credited to the account "Reserve for Accrued Depreciation" are the original cost of the property, the then expected net salvage, the then expected term of its useful life, and the co-efficient of safety which good business management requires in cases where expense items are to be met, the exact amount of which cannot be known in advance. In the case of those portions of the property composed of a large number of similar items, like poles or feet of cable, the factors then required are the aggregate original cost, the then best estimates to be made of their average expectancies of net salvage, and average expectancies of useful life, as well as the co-efficient of safety above mentioned.

For example: assume that a switchboard will cost \$1,000,000; assume that according to present outlook its service life will be 10 years, and that it will have a net salvage value of \$100,000 upon retirement. These factors, together with a coefficient of safety or reasonable margin to come and go on, determine the amount of and the rate of the expense of depreciation. Disregarding the last or safety factor, the expense for 10 years will be \$900,000. The annual rate of depreciation expense currently to be charged will be one-tenth of 9%, the annual amount will be \$90,000, or \$7,500 a month.

The original cost is readily and definitely ascertainable. What [fol. 115] will be the useful life of any piece of telephone property and what will be the net salvage recovered upon the termination of this life are factors looking to the future which must necessarily be based upon estimates founded upon the judgment of those familiar with the business applied to the recorded experience of the company over a series of years.

The exact time when any specific piece of property will go out of use may not be precisely determinable. Likewise, the average life expectancies of certain classes of property made at one time may,

because of changing conditions, require some modifications at some subsequent time. But as of any particular period the then average useful life expectancies of the various classes of property, each class composed of large numbers of similar units, can, as of the particular period and its facts, and with help of past experience as a guide, be fixed with substantial accuracy. The same is true also as to the determination of average net salvage expectancies.

The determinations of the above mentioned factors upon which these charges to operating expenses depend, should, however, as indicated in the preceding, be reviewed from time to time, and when changes in conditions or in character of plant are found which appear to be more than temporary, and hence such as to affect substantially these averages, corresponding adjustments should be made; to the end that the expenses being currently charged during any one period may be in accordance with the then outlook for average lives and net salvage for the same period. With substantial accuracy thus maintained for the several periods constituting the average useful lives of the property subdivisions, no errors of serious magnitude will be introduced into aggregate charges made to expenses on this account during the total useful lives of the same property.

During the last ten years it has been part of my duty to study, continuously, the facts bearing upon these factors of useful life and net salvage, for use as a basis for revisions of charges to operating expenses and credits to account "Reserve for Accrued Depreciation" when changed conditions made revisions of such charges proper.

The last such revision was as of March 1, 1923, and resulted in a schedule of rates for the various classes of depreciable property herein referred to which produced a composite annual rate for the expense of depreciation, when applied to the plaintiff's average property in New Jersey for the year 1924, of 5.16%.

The particular rates in this schedule for the several classes of depreciable property hereinbefore mentioned are as next shown:

212.	Buildings	2.1
	Cable, Aerial—	
242.	Exchange	6.2
252.	Toll	4.0
	Cable, Underground—	
245.	Exchange, Main	2.5
245.	Exchange, Subsidiary	6.0
255.	Toll	2.5
	Cable, Submarine—	
246.	Exchange	7.0
256.	Toll	7.0
221.	Central Office Telephone Equipment	7.5*
222.	Other Equipment of C. O.	8.0

*The rate above shown of 7.5% for account 221, Central Office Telephone Equipment, is a weighted average for the particular quantities and types of central office telephone equipment in the plaintiff's property in New Jersey in 1924.

Conduit, Underground—

244.	Exchange, Main	2.0
244.	Exchange Subsidiary	4.0
254.	Toll	2.0
261.	Office Furniture and Fixtures	7.0

Pole Lines—

241.	Exchange	7.5
251.	Toll	6.0

[fol. 116] Right of Way—

207.	Exchange	5.0
207.	Toll	2.5

Station Equipment—

231.	Station Apparatus	4.5
232.	Station Installations	1.0
233.	Interior Block Wires	4.0
234.	Private Branch Exchanges	5.0
235.	Booths & Spl. Fittings	3.6
262.	General Shop Equipment	10.0
264.	General Stable and Garage Equipment	15.5
263.	General Store Equipment	5.0
265.	General Tools and Implements	25.0

Wire, Aerial—

243.	Exchange	7.6
253.	Toll	4.8

In my opinion, based upon my recent study and investigations of the matter, the foregoing schedule is a fair and substantially accurate one to apply to the plaintiff's present property in New Jersey, in order to obtain proper amounts to charge to expenses as representing, at the present time, the losses being currently suffered in the plaintiff's tangible fixed capital, or depreciable property, in the rendition of its service. I believe that any other schedule of depreciation rates which would produce an amount substantially less than that resulting from the application of the above schedule of rates would be incorrect in that it would not properly reflect the depreciation losses as defined and provided for in the prescribed accounting system and now currently being incurred by the plaintiff in its New Jersey property.

In the contract made between the Postmaster General and the plaintiff in connection with the federal possession, control and operation of the plaintiff's property during the year from August, 1918, to August, 1919, the comparable composite rate for the charges to operating expenses and clearing accounts and credits to the account "Reserve for Accrued Depreciation" was fixed at 5.72%. This composite figure was applied to plaintiff's total depreciable property during the year of Federal operation.

I have read the order and decision of the Board of Public Utility Commissioners of New Jersey, dated December 31, 1924, complained of in this suit and, in particular, that part of said order covering

schedule of Annual Depreciation rates to be charged by plaintiff on and after January 1, 1925, to wit:—

Account	Annual depreciation rate — %
Exchange Right of Way	5.26
Toll Right of Way	4.55
Buildings	2.67
Central Office Equipment	5.00
Other Equipment at Central Offices	5.38
Station Apparatus	2.95
Station Installations	1.00
Interior Block Wire	4.00
Private Branch Exchange	3.14
Booths and Special Fittings	3.47
Exchange Pole Lines	7.66
“ Aerial Cable	4.45
“ “ Wire	10.50
“ U. G. Conduit, Main	1.33
“ “ “ Subs	4.00
“ “ Cable, Main	1.95
“ “ “ Subs	4.09
“ Submarine Cable	4.54
Toll Pole Lines	5.09
“ Aerial Cable	2.42
“ “ Wire	3.47
“ U. G. Conduit	1.33
“ “ Cable	2.17
[fol. 117] Toll Submarine Cable	3.73
Office Furniture and Fixtures	5.27
Interest during Construction	4.28
Store Equipment	5.75
Stable and Garage Equipment	15.46
Tools and Implements	13.33

In the Uniform System of Accounts prescribed for Telephone Companies by order of the Interstate Commerce Commission, dated December 10, 1912, the following direction appears:

“The amount charged as expense of depreciation should be based upon rules determined by the accounting company. Such rules may be derived from a consideration of the company's history and experience. Companies should be prepared to furnish the Commission, upon demand, the rules and a sworn statement of the facts, expert opinions, and estimates upon which they are based.”

The rates adopted by the plaintiff hereinbefore stated were made in accordance with the requirement contained in the above-quoted provision. If I were called upon to submit sworn statements or testimony as to the annual rates of depreciation to be charged by plaintiff in New Jersey I would be unable to support the rates as prescribed by said Board in its said order, and set forth in the

schedule above. On the contrary, it is my opinion that the schedule of rates now used by plaintiff and above set forth produce no more than a sum sufficient to meet the expense of depreciation now currently accruing in the plaintiff's property.

The foregoing schedule of rates ordered by the defendant I believe to be wrong and inaccurate in that the amount which would be derived from the application of said rates to the plaintiff's present New Jersey property would fail substantially to meet the charges properly to be made to expenses on account of depreciation losses currently accruing in said property. The deficiency in depreciation expenses resulting from the application of the rates prescribed by said Board to the average property of plaintiff in New Jersey for the year 1924 would be \$679,000. As to a majority of the accounts, the aggregate charges to expense produced by the rates prescribed in said order would not be substantially lower than the aggregate sum resulting from the application of the plaintiff's rates. In several accounts there are marked differences however and the rates prescribed in said order are wrong for those accounts for the following reasons:

A—Rate for Central Office Telephone Equipment—Account 221

Plaintiff's depreciation rate for this class of property is 7.5% and that prescribed by said Board in its said order is 5%. The difference which would occur in the annual charges to expense and credits to the Reserve for Depreciation by the application of these rates may be measured by the following figures.

Applied to the average book cost of this class of property in the State of New Jersey in the year 1924, \$14,840,000, the amount to be charged to expense and credited to the reserve as aforesaid is less under the Board's rate by \$370,000, which deficiency would be substantially greater in 1925 by reason of additions to the property to be made in that year.

Said difference in the depreciation rate results from the use of an estimated average life of 16 years by said Board as against 10.5 years by plaintiff and an estimated net salvage of 20% by said Board as against 10% by plaintiff.

[fol. 118] The foregoing factor of expected average life of 16 years I believe to be wrong in two particulars: first, as to methods, or methods, followed in its derivation; second, as to results secured—16 years. The actuarial method used by the defendant for determining average life expectancies, while suitable to problems involving large numbers of similar initially complete units, like ten thousand or more of human lives, poles, feet of cable, or subscribers' sets (Account 231), is forced into an improper use when applied, as by defendant, to a relatively small number (about 50) of individually varying, initially incomplete, and constantly growing and changing items or installations. In much the larger part, increases in plaintiff's investment in central offices in New Jersey during the past 10 or 15 years have not been for constructing new offices but for additions to already existing offices. In such latter instances, dollars added at

some later date to those previously expended in establishing initially some item of property, like a central office, cannot properly be viewed as then at the start of an independent, detached life history. On the contrary, such new dollars can then only have a life expectancy at the time spent, limited to the remaining service life of the office as then enlarged. In many instances such later expenditures, justifiable economically from the standpoint of total dollars involved, can have life expectancies of but a very few years. Furthermore, only to a limited extent have withdrawals thus far of complete central offices of present type occurred, or been definitely fixed, (eight instances of latter, as in Exhibit G. W. W. No. 1, hereto attached). Most of the retirements shown on plaintiff's records for central office equipment have been of parts of offices still continuing in service; something quite different in nature from retirements of complete units. Had the above-mentioned \$14,840,000 for central office equipment been divided into, say 50,000 separate, generally uniform, units averaging about \$300 each, and each remaining practically unchanged during its useful life, the propriety of use by the Board of an actuarial method to reach average life expectancy of such items would be accepted.

Such actuarial method entirely fails of proper applicability when the problem deals, as in this instance, with about only 50 widely differing, constantly changing and expanding items, ranging in cost from a few thousand to over a million dollars. In other words, to treat as practically identical, as is done by the Board, two problems so dissimilar as the foregoing will lead, and has led, to erroneous conclusions.

Nor is any claim defendant may make as to the fitness of the above method for use in case of central office equipments strengthened in any way by its showing results obtained from use of a second method; viz., the accumulation of gross additions, which is equally objectionable, when applied to few units of large and diverse characteristics, for application to this particular problem. Its unsoundness in such cases is proven by the fact that the second method applied by the Board to the account "Buildings—212" produced an answer which differs by 25% from the answer secured by said Board under its first method.

Apart from the use by defendant of an improper method of arriving at this factor, and one from which no correct answer could really be expected, the result itself—16 years average useful life—is at wide variance with facts already known and consequently is highly improbable. Such improbability is indicated by the following facts taken from plaintiff's actual experience in the State of New Jersey with respect to this class of property.

[fol. 119] (1) The average age of eight central officers already retired or soon to be retired is much less than sixteen years. (See table hereto attached and made a part hereof and marked "Exhibit G. W. W. No. 1.") Of eight such officers three have an average life of less than six years, four between six and eight years and one of 11.97 years.

(2) The average age of all other common battery offices in New Jersey has not at any time approached sixteen years and has heretofore rarely exceeded ten years. (See table hereto attached and made a part hereof and marked "Exhibit G. W. W. No. 2.")

(3) The necessity of continuing to make additions to the central officers in service to provide for growth of the business up to within a few years of their actual retirement.

Based on these facts and my judgment and experience as an engineer familiar with plaintiff's property it is my opinion that no modification of the estimate of an average useful life of 10.5 years for central office telephone equipment in New Jersey is warranted.

The estimated average net salvage used by said Board in arriving at its depreciation rate of 5% for this class of property is 20%. This is higher than present expectations would justify. During the war-period and the years immediately following (1914-1920) the demand for this class of equipment was large while the production by the manufacturer was restricted. Consequently the re-use of this kind of plant when removed was greater than usual. The salvage percentages in recent years have shown a marked shrinkage, the average for the four years 1921-1924 being 4.52% as compared with 43.7% in the years 1914-1920 preceding. Unless another World War is to be included in estimating the probable influence upon this factor, the net salvage to be realized in the future should more closely approximate the conditions of the past three years than those of the war period. In my opinion also central office retirements thus far experienced do not, in type nor character, in any sufficient degree indicate what such retirements and consequent net salvage will be when additions and extensions to offices of the manual type heretofore generally in use materially fall off or cease and are supplanted by the newer type (machine switching) now generally coming into use. At such time, toward the close of the useful life of such property with its then greatly diminished demand for re-use of such equipment, no great salvage can be expected.

B—Rate for Station Apparatus—Account 231

Plaintiff's depreciation rate for this class of property is 4.5% and that prescribed in said order of said Board is 2.95%. This difference is caused by the use by the said Board of an estimated net salvage figure of 82% as against 73% used by plaintiff. The recent and present experience of the plaintiff shows net salvage of about 76.6% being realized. The increase in the proportion of units installed at prevailing higher costs raises the average cost per unit and causes the salvage to decrease as a percentage of the cost, even though the present relatively high salvage value in dollars of each unit continues to prevail. The expectancy of average net salvage will, therefore, be lower than the present percentage and not higher. The Board's use of 82% is, therefore, wholly untenable.

C—Rate for Exchange Underground Cable Subsidiary—Account 245-25

Plaintiff's depreciation rate for this class of property is 6% and [fol. 120] that prescribed in said order of said Board is 4.09%. The difference is in part due to the use of different estimates of average net salvage, said Board using a percentage of 18.1 against plaintiff's percentage of 10. The average salvage on this class of property previous to the war was 8.7% and the recent experience of plaintiff shows a salvage of 10.2%. Said Board's estimate is based in part upon, and more closely approximates, the salvage obtained in the war years and those immediately following, which was 25.7%. The salvage in those years was no criterion of the amount to be realized under normal conditions.

D—Rate for Private Branch Exchanges—Account 234

Plaintiff's depreciation rate for this class of property is 5% and that prescribed in said order of said Board is 3.14%. The difference in the rates is primarily caused by the Board's use of 78% for estimated average net salvage as against 67% by plaintiff. The conditions applying to the salvage percentage in this account are similar to those discussed above in connection with the rate for Station Apparatus—Account 231. An extended discussion with regard to this Account is therefore unnecessary.

I have also read those portions of the defendant's order and decision dealing with an alleged "excess" of \$4,750,000 in the plaintiff's "Reserve for Accrued Depreciation" associated with its New Jersey property as of same date; and, apart from lack of any legal warrant supporting defendant's orders respecting any such "excess," if one did actually exist, it is my opinion that the defendant is in error when it finds that plaintiff had on its books any such "excess" reserve, and this for the following reasons:

First, the plaintiff's present reserve is the result of the application of depreciation rates representing the best judgment of its engineers when made, in the light of plaintiff's then experience. The most recent review of the facts, experience and future expectancies indicates that the present reserve is not excessive.

Second, the alleged "excess" in the reserves claimed by said Board is predicated upon and is merely the result of extending into previous years the annual depreciation rates prescribed by said Board for 1925 and succeeding years. I have stated heretofore my reasons for my opinion that the rates prescribed in said order are erroneous and as the existence of the alleged "excess" is dependent wholly upon the accuracy of the depreciation rates prescribed, it disappears when the errors in the rates themselves are shown, as above.

Third, the Board in its said order fails to distinguish properly the depreciation now existing in the plant from the balance in the reserve accounts. It refers to the difference between the existing deprecia-

tion and what it styles a "normal reserve" as a "cushion." The existing depreciation covers only those defects or deficiencies in the property discoverable at the time of the inspection of the property; such as, wear, physical decay, already definitely disclosed instances of inadequacy to meet approaching increased demands for service, etc. The second amount, called by the defendant its "normal depreciation reserve," is the estimate by said Board based upon its assumptions and methods; its opinions as to salvage hereafter to be expected; upon its choice and use of certain hypothetical "normal probability life curves" used by its expert but not introduced in evidence; and upon its distribution of plant additions in early years. These foregoing steps or methods resulted in said "normal reserve," which had nothing in it in the way of a "cushion" or margin or allowance for safety to counterbalance any errors which later experience might show defendant to have made in its said assumptions, opinions, curves, computations, forecasts of future, etc.

The difference between these two amounts is not a "cushion" but rather the difference between two dissimilar things. The physical depreciation proceeds on a curve quite different from the straight line upon which credits to the reserve are made. For example, assume a piece of property costing \$100,000 upon which the annual credit to the reserve is \$10,000. The estimated life of this property is ten years and the salvage zero. At the end of two years the credits to the reserve will amount to \$20,000. At that time, it may well be, that the physical depreciation actually existing will not exceed \$8,000. The difference of \$12,000 is entirely normal and properly and equitably assignable in the case assumed to the two years elapsed. Assuming the property lives out its full average life, the existing discoverable depreciation will always be lower than the balance in the reserve until the end of the period. For instance a central office switchboard, the depreciation reserve for which has been set up on the basis of a life of ten years and a net salvage of 10%, would ordinarily not exhibit a physical depreciation at the end of five years equal to the reserve then existing, but when the switchboard comes out at the end of ten years and is scrapped it will be found that the depreciation reserve set up for it will approximately equal the original cost less the salvage. Of course, in the accounting all the property of a class and averages are used. This is the normal case. On the other hand in a case where property by reason, we will say, of a sleet storm or something specifically unforeseen is retired before the expiration of its average life the amount of the retirement may at any time exceed the amount in the reserve. In the case above cited, if for some reason the property must be retired at the end of the second year the reserve of \$20,000 associated with this item of plant will be insufficient to meet the charge of \$100,000 caused by its retirement. This should normally be offset by instances of plant remaining in service beyond the average life.

The only place then to which any reference of a "cushion" is relevant or possessed of meaning (if, as defendant's comments in its decision seem to imply, such "cushion" or allowance for possible errors in estimates should be made) is in additions to allowances for

"annual depreciation expenses," or in its "normal depreciation reserves," both of which are entirely without any such "cushion."

So far as the opinion of said Board that an "excess" in the reserve exists is based upon the comparison of the plaintiff's reserve with the depreciation now existing in the property, it is erroneous as above stated, the two figures being in no way comparable.

(Sd.) George W. Whittemore.

Subscribed and sworn to before me this 29th day of January, 1925. (Sd.) Edward C. Ryder, Notary Public. Notary Public for Queens County. Certificate Filed in New York County. New York County Clerk's No. 321. Register's No. 5274. My commission expires March 30, 1925. (Seal.)

[fol. 122] EXHIBIT G. W. W. No. 1 TO AFFIDAVIT OF G. W. WHITTEMORE

Summary

Average Service Life to be Secured from Manual Common Battery
Offices in the New Jersey Division to be Retired as in Structural
Value Exhibit by End of Year 1927

Name of office	Year of		Book cost		Average life secured from investment
	Original installation	Retirement	12-31-23	At retirement	
Englewood	1907	1926	\$100,650	\$143,861	6.23
New Bunswick... .	1907	1925	138,095	148,843	7.09
Perth Amboy.... .	1907	1926	120,909	131,809	7.18
Ridgewood	1908	1927	77,953	125,553	7.21
Roselle	1902	1926	182,638	180,618	11.97
Rutherford	1907	1925	117,253	141,413	5.44
South Orange... .	1907	1923	131,548	232,548	4.70
Lakewood	1916	1926	66,382	82,217	5.03

[fol. 122-a] EXHIBIT G. W. W. No. 2 TO AFFIDAVIT OF G. W. WHITTEMORE

Summary

Average Ages as of 12-31-23 of Manual Common Battery Offices in New Jersey Division to be Continued in Service After 1927

Name of office	Year of original installation	Book cost 12-31-23	Average age of investment		
			When at maximum		As of 12-31-23
			Year	Age	
Asbury Park.....	1911	279,217	1920	6.30	4.84
Bayonne	1915	186,036	1920	3.85	3.73
Belleville	1923	3,406	1923	.50	.50
Bergen	1906	532,534	1919	7.59	5.08
Bigelow	1920	375,099	1923	2.55	2.55
Boonton	1915	27,049	1923	5.29	5.29
Bound Brook.....	1914	25,331	1921	5.76	5.04
Caldwell	1911	36,555	1920	7.71	5.53
Cliffside	1911	66,442	1921	5.88	4.62
Cranford	1912	23,060	1923	7.21	7.21
Dover	1912	39,990	1920	6.31	5.36
Hackensack	1913	214,759	1921	5.67	3.72
Hoboken	1907	505,583	1918	6.89	4.65
Kearney	1913	70,562	1921	6.12	5.68
Keyport	1916	15,016	1923	5.37	5.37
Lambert	1900	358,578	1918	9.01	7.64
Leonia	1911	49,062	1921	6.94	5.23
Long Branch.....	1911	104,681	1921	7.80	7.11
Madison	1910	18,586	1921	9.17	8.25
Market	1910	1,213,340	1919	6.46	5.77
Milburn	1909	33,316	1921	7.85	5.88
Mitchell	1920	430,624	1923	1.54	1.54
Montclair	1905	414,147	1921	8.70	5.37
Montgomery	1903	783,791	1919	10.08	4.79
Morristown	1905	90,630	1921	10.19	8.20
Orange	1904	539,105	1919	9.21	6.79
Palisade	1923	165	1923	.50	.50
Passaic	1907	272,418	1919	7.87	6.03
Plainfield.....	1907	156,064	1920	10.82	8.65
Rahway	1911	29,945	1921	7.90	7.07
Red Bank.....	1911	76,783	1921	7.92	7.13
Sea Bright.....	1911	26,237	1921	8.44	7.45
Somerville	1916	27,320	1923	4.87	4.87
Spring Lake.....	1911	53,272	1920	6.58	5.60
Summit	1908	60,535	1921	9.53	7.11
Trinity	1921	87,077	1923	1.28	1.28
Union	1909	480,757	1921	6.57	4.52
Westfield	1910	41,040	1921	8.21	7.24

[fol. 123]

IN UNITED STATES DISTRICT COURT

[Title omitted]

AFFIDAVIT OF ANDREW SANGSTER—Filed Jan. 25, 1925

On Depreciation Accounting

STATE OF NEW YORK,

County of New York, ss:

Andrew Sangster, being duly sworn according to law on oath, says:

I am the Andrew Sangster who made the affidavit respecting the separation of the property, revenues, and expenses of the Plaintiff between its interstate toll business and its general intrastate exchange and toll business in the State of New Jersey, verified January 29th, 1925.

I am familiar with the rules and regulations prescribed by the Interstate Commerce Commission in the Uniform System of Accounts for telephone companies, in its order dated December 10th, 1912, effective January 1, 1913, a copy of which is hereto annexed and marked Exhibit A. S. No. 1, concerning the method of accounting for the expense of depreciation to be included in Operating Expense Accounts, and for the Amortization of Landed Capital to be included in Deductions from Gross Income, and I am familiar with the accounting practices of the Plaintiff under these rules and regulations.

Telephone companies are required to include in their Operating Expense Accounts depreciation charges for the purpose of creating proper and adequate reserves to cover the expense of depreciation currently accruing in the tangible fixed capital. For this purpose the Uniform System of Accounts prescribes the following accounts with explanatory text pertaining to each account:

Operating Expense Accounts (at p. 71)

* * * * *

"608. Depreciation of Plant and Equipment:

Charge to this account monthly the amount estimated to be necessary to cover the depreciation accruing during the month in the company's tangible fixed capital (except depreciation provided in 'Clearing Accounts,' Nos. 701, 702, and 703). Amounts charged to this account should be concurrently credited to account No. 102, 'Reserve for Accrued Depreciation—Cr.' (See sec. 23, p. 67.)"

"609. Extraordinary Depreciation:

This account should be charged monthly with such an amount as will, through its regular application, amortize any amount that may be carried in suspense on account of extraordinary casualties and unanticipated reconstruction. (See sec. 24, p. 68.)"

[fol. 124] "611. Repairs Charged to Reserves—Cr.:

Credit to this account and charge concurrently to account No. 102, 'Reserve for Accrued Depreciation—Cr.,' an amount equal to the cost of extraordinary repairs made for which provision had been made in that reserve; also, credit to this account and charge concurrently to the insurers or to the insurance reserve an amount equal to the cost of repairs made necessary by casualties, when such cost is covered by insurance or an insurance reserve. (See sec. 21, p. 66.)"

* * * * *

Balance Sheet Accounts (at p. 16)

* * * * *

"102. Reserve for Accrued Depreciation—Cr.:

Credit to this account such amounts as are concurrently charged to account No. 608, 'Depreciation of Plant and Equipment,' No. 701, 'Shop Expense,' No. 702, 'Stable and Garage Expense,' and No. 703, 'Tool Expense' to cover the expense of depreciation of plant, equipment, furniture, tools and implements, as specified in the text of these accounts. This account should also be credited with any amount carried in reserve on January 1, 1913, to cover the expense of depreciation on Plant, equipment, furniture, tools and implements installed prior to that date.

Charge to this account the realized depreciation of tangible fixed capital installed since December 31, 1912, when such capital is relinquished, retired, or destroyed, also the amount of depreciation carried herein in respect to tangible fixed capital installed prior to January 1, 1913, when relinquished, retired, or destroyed. (See secs. 14 p. 34, and 23, p. 67.)

Charge also to this account such part of the expenditures for extraordinary repairs as is concurrently credited to account No. 611, 'Repairs Charged to Reserves—Cr.,'

* * * * *

The instructions pertaining to the foregoing accounts are set forth in Secs. 23 and 24 of the General Instructions pertaining to Operating Expense Accounts (page 67 of said Uniform System of Accounts), copy of said Instructions being hereto attached as Exhibit "A. S. No. 2" and made a part hereof.

Telephone companies are also required to include in Deductions from Gross Income during each fiscal period charges for the purpose of creating reserves to cover the depreciation of landed capital currently accruing during such period. For this purpose said Uniform System of Accounts prescribes the following accounts with explanatory text pertaining to each account:

Deductions from Gross Income (at p. 53)

* * * * *

340. Amortization of Landed Capital:

Charge to this account during each fiscal period such portion of the original money cost (estimated, if not known) of landed capital as is carried in account No. 207, 'Right of Way,' and No. 211, 'Land,' as is necessary to cover the proportion of life thereof expired during each period.

Note A.—The amounts charged to this account should be concurrently credited to account No. 103, 'Reserve for Amortization of Intangible Capital—Cr.'

Note B.—When any landed capital expires or is otherwise retired from service (as e. g., through sale) the fixed capital account or investment account, if any, originally charged therewith should be credited with the amount originally charged, account No. 103, 'Reserve for Amortization of Intangible Capital—Cr.,' should be debited with all amounts theretofore credited to such account in respect of such capital so going out of service; the appropriate account should [fol. 125] be debited with the proceeds of sale, if any, and any necessary adjustment should be made through the Corporate Surplus or Deficit account."

* * * * *

Balance Sheet Accounts (at p. 17)

* * * * *

103. Reserve for Amortization of Intangible Capital—Cr.

Credit to this account such amounts as are concurrently charged to account No. 340, 'Amortization of Landed Capital,' and to account No. 674, 'Amortization of Franchises and Patents.' Charge to this account when any franchise, patent, or landed capital expires or is relinquished, the amount at which it stood charged in the company's fixed capital accounts or such portion thereof as has been previously credited to this reserve. When any intangible capital acquired prior to the raising of this reserve expires or is relinquished, that portion of its cost which has not been covered by credits to this account or previously written off should be charged to account No. 414, 'Amortization Unprovided for Elsewhere.' "

In the introductory letter of the Chief Examiner of Accounts of the Interstate Commerce Commission, dated December 10, 1912, page 7 of the Uniform System of Accounts, Plaintiff is explicitly instructed that "the observance of the rules and regulations stated in this System of Accounts, therefore, becomes obligatory upon persons having direct charge of the accounts of the companies concerned and such persons will be held responsible for their proper application."

Sec. 435 of the Transportation Act, 1920, amending paragraph 5 Sec. 20 of the Interstate Commerce Act, became effective February 1, 1920, and provides that the commission shall, as soon as practicable, prescribe, for carriers subject to this Act, the classes of

property for which depreciation charges may properly be included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property." After the passage of said amendment, the Interstate Commerce Commission engaged in carrying out the directions and divers and extended investigations and proceedings have been made and conducted and hearings held. Pending its final determination, the Interstate Commerce Commission issued and served upon Plaintiff an order dated March 18, 1920, copy of which is hereto attached as Exhibit "A. S. No. 3," which said order provides that

"until the Commission shall otherwise order, all carriers subject to the Act to Regulate commerce should continue to observe the requirements respecting the accounting for depreciation which are embodied in the effective accounting classifications prescribed by the Commission for the respective classes of carriers."

Pursuant to the foregoing instructions plaintiff includes in its Operating Expense Accounts, during each fiscal period, depreciation charges to cover the expense of depreciation currently accruing in the tangible fixed capital, and also includes in its Deductions from Gross Income during each fiscal period charges for Amortization of Landed Capital to cover the proportion of life thereof expired during such period.

I have read the Order of the Board of Public Utility Commissioners [fol. 126] of the State of New Jersey, issued December 31, 1924, in the matter of the schedules filed by the New York Telephone Company increasing rates and charges for telephone service in the State of New Jersey, and the decision of said Board setting forth its findings of fact and conclusions thereon made and filed as part of said order, particularly those sections of said order and decision relating to expense of depreciation and reserves for depreciation and amortization of intangible capital. Said decision on page 86, par. 2 and 3 (Exhibit "A" to Bill of Complaint) finds as follows:

"* * * that the company has charged to expenses and credited to reserves, at least \$4,750,000, as above indicated, which amount is in excess of the amount warranted, and therefore, future charges computed at the depreciation rates hereinafter fixed should be decreased sufficiently to absorb this overcharge.

From the amounts ascertained by the application of the depreciation percentages hereinafter provided, on and after January 1st, 1925, the Board will direct the company to deduct such amount of depreciation expenses as will permit the resultant net telephone earnings to equal the fair return as herein found; this procedure to be followed until the excess credit of \$4,750,000, above referred to is absorbed."

Said order of December 31, 1924, in paragraph (a) directs the plaintiff to set up on its New Jersey Division ledger an account entitled "Reserve for Depreciation, Credit" and an account entitled "Reserve for Amortization of Intangible Capital, Credit," the

amount to be stated as the balance on December 31, 1923, in each of these accounts being as follows:

Reserve for Depreciation, Credit	\$16,571,338.
Amortization of Intangible Capital Credit	331,192.

Said order in paragraph (b) also directs that the entries made by plaintiff subsequent to December 31, 1923, with respect to each of these reserves shall be made as required by the Uniform System of Accounts for telephone companies prescribed by the Interstate Commerce Commission and adopted by said Board of Public Utility Commissioners of the State of New Jersey and to accord with the findings set forth in said order.

Said order in paragraph (c) fixes the depreciation percentages or rates to be applied to the respective ledger balances of fixed capital on and after January 1, 1925, for the purpose of determining the charges to Depreciation Expense and to Amortization of Landed Capital.

Confirming the findings relating to an alleged excess of depreciation reserve set forth in the decision and order referred to above, said order in paragraph (d) directs the plaintiff to modify the amount of expense of depreciation and amortization of landed capital to be determined on the basis of the annual depreciation rates prescribed in paragraph (c) of the order in the following manner:

"Beginning with January 1st, 1925, the debits to expenses as provided in (c) foregoing shall be decreased by an amount which will permit the resultant net telephone earnings to equal the fair return on the fair value of its property in service as indicated herein, continued to subsequent dates by the use of book net additions, and the difference shall be charged to expenses and concurrently credited to the proper reserve. When the total deductions from the normally required depreciation expense shall have aggregated a total of \$4,750,000. such deductions shall [fol. 127] be no longer made."

The above provisions of said decision and order of December 31, 1924, of the Board of Public Utility Commissioners of the State of New Jersey are in violation of the above mentioned orders, rules and regulations of the Interstate Commerce Commission in the following respects:

1. As before stated, the said orders, rules and regulations of the Interstate Commerce Commission require plaintiff to determine the true and proper rates per cent. to be charged as expense of depreciation, the same to be based upon the company's history and experience and upon the average life of the units comprised in the several classes of property, and the average salvage, and so fixed as to distribute the depreciation as nearly as may be evenly throughout the life of the property, and also requires the plaintiff to furnish the Commission, upon demand, a sworn statement of the facts, expert opinions and estimates upon which they are based. The said order, on the other hand, fixes rates of depreciation which have

not been determined by the plaintiff and which are not, as I am advised by the engineers of the plaintiff, in accordance with its history and experience, and which plaintiff would be unable to verify under oath to the said Interstate Commerce Commission, if called upon to do so, and which said rates are different from, and less than, the true and correct rates as appears from the affidavit of George W. Whittemore, verified January 29th, 1925, filed herein.

2. Plaintiff has no authority under the Uniform System of Accounts to reduce its current charges on account of the expense of depreciation or the amortization of rights of way (landed capital) etc., as a compliance with the said order of December 31, 1924 would require, because of any actual or alleged excess in the corresponding reserve for depreciation or reserve for amortization; but on the contrary the Uniform System of Accounts does require plaintiff to charge currently from month to month as and for expense of depreciation and amortization the true and correct percentages representing the expenses currently accruing therefor, to be ascertained in accordance with the said accounting rules and regulations.

Indeed, the regulations above quoted only permit to be charged against the credit set up in the depreciation reserve actual retirements of property at its actual cost less net salvage at the time the property is retired. The order of the Board would in effect require the plaintiff to charge against the credit to the reserve for depreciation something entirely different, namely, an estimated amount of a theoretical excess in the reserve for depreciation.

The Uniform System of Accounts definitely prescribes the procedure to be followed where the amounts accumulated in these reserves are inadequate to cover the realized depreciation on tangible fixed capital when such capital is relinquished, retired or destroyed, or the cost of Landed Capital when such property is taken out of service.

Sec. 23, Par. 6 of the Instructions pertaining to Operating Expense Accounts (Exhibit "A. S. No. 2" attached hereto) provides a special account to which shall be charged the realized depreciation on tangible fixed Capital when such depreciation has not been provided for by credits to Account 102, Reserve for Accrued Depreciation—Cr. In the text pertaining to the Corporate Surplus or Deficit Account, the Uniform System of Accounts provides the following account with the text relating thereto.

* * * * *

Corporate Surplus or Deficit Account—Debits (at p. 58)

* * * * *

"413. Realized Depreciation not covered by Reserves.

Charge to this account the realized depreciation (i. e., the difference between the original cost and the salvage, if any) on tangible

fixed capital retired, if such depreciation has not been provided for through a depreciation reserve. This includes such portion of the realized depreciation on any physical property which was installed prior to the period for which the reserve was established as is due to life in service before that period. This portion may be estimated on the basis of the proportion which the life in service of the property in question prior to the period for which the reserve was established bears to its entire life in service. (See sec. 23, p. 67.)"

* * * * *

In the foregoing text there is also provided an account to which is to be charged the cost of Landed Capital which has expired or is relinquished and is not covered by Account 103 Reserve for Amortization of Intangible Capital—Cr. Such account with the explanatory text is as follows:

* * * * *

Corporate Surplus or Deficit Account—Debits (at p. 58)

* * * * *

"414. Amortization Unprovided for Elsewhere.

Charge to this account, when any intangible property expires or is relinquished such portion of its cost as has not been previously written off or is not covered by Account No. 103, 'Reserve for Amortization of Intangible Capital—Cr.' Charge also to this account all optional amortization, such as that of assets carried in accounts No. 201, 'Organization' and No. 204, 'Other Intangible Capital.'"

* * * * *

In making specific provision for Accounts 413 and 414 in the text explanatory of Corporate Surplus or Deficit Account in said Uniform System of Accounts the Interstate Commerce Commission recognized that the Expense of Depreciation and the income deduction for Amortization of Landed Capital are necessarily based upon estimates, and that although they represent the charges of a given month or year as nearly as can be determined at the time, it would be necessary to provide accounts which would adjust the differences, if any, between the estimates and the facts when ascertained so that the expense accounts and income deductions of any fiscal period should not be distorted by adjustments of operating expenses and income deductions pertaining to a period or periods long expired. It is obvious that if Accounts 413 and 414 had not been provided for the special purpose of absorbing differences between the amounts accumulated in the reserves and the realized depreciation not covered by such accumulation, it would have been necessary to increase the charges to Expense of Depreciation or to Amortization of Intangible Capital so as to maintain proper and adequate reserves. The instructions are consistent, however, and it

is the duty of every telephone company, including the plaintiff, to [fol. 129] charge the Expense of Depreciation and the Amortization of Landed Capital currently accruing during a given month or year and to maintain proper and adequate reserves.

The other contingency, wherein extraordinary losses may occur of such a nature that they could not possibly be anticipated by the exercise of reasonable prudence, is also recognized by the Uniform System of Accounts and special provision made therefor, so that the accounts for Expense of Depreciation and Amortization of Landed Capital may not be disturbed and that they may, as nearly as practicable, correctly represent the expense of Depreciation and the Amortization of Rights of Way, etc., currently accruing during a given month or year (See sec. 24, Exhibit "A. S. No. 2" attached). The account provided for this contingency being an Operating Expense Account, application must be made to the Commission for authority to include extraordinary casualties and unanticipated losses in the current operating expenses.

Under the regulations of the Interstate Commerce Commission Plaintiff is required to and does file an annual report as of December 31st showing among other things its assets and liabilities as at January 1st and December 31st including the balances in its Account 102-Reserve for Accrued Depreciation-Cr., and 103-Reserve for Amortization of Intangible Capital-Cr., the credits and charges to each of these accounts, and the composite rates of Depreciation and Amortization of Landed Capital charged in Operating Expense Accounts during the year.

3. Plaintiff has no authority to use, as a compliance with said order of December 31, 1924, would require, any portion of the balance in its Account 102-Reserve for Accrued Depreciation-Cr., or in its Account 103-Reserve for Amortization of Intangible Capital-Cr. for any purpose other than that for which each of these said accounts has been prescribed, or to reduce the expense of Depreciation and Amortization of Landed Capital charged to its Operating Expense Accounts and to its Deductions from Gross Income respectively, for the purpose of increasing its net telephone earnings derived from the rates charged to its subscribers in the State of New Jersey. Plaintiff has accordingly no authority to divert such reserves or provision for depreciation and amortization for the ulterior purpose of artificially creating net earnings sufficient for the payment of dividends or returns to its stockholders.

Said Board of Public Utility Commissioners of the State of New Jersey, on page 87 of its Decision above referred to (Exhibit "A" to Bill of Complaint) likewise points to the illegality of any diversion of the balances in the reserves in the following paragraph:

"The policy of this State with reference to the treatment of depreciation in the property of a public utility and the maintenance of a reserve therefore is indicated by the statutory provision found in Chapter 195, P. L. 1911, Sec. 17, which empowers the Board to require a public utility to carry a proper and adequate depreciation

account and fix proper and adequate rates of depreciation. The Act provides that this fund 'shall not be expended otherwise than for depreciation, improvements, new constructions, extensions or additions to the property of such public utility.'"

[fol. 130] Said Board of Public Utility Commissioners in said Decision (page 87, Exhibit "A" to Bill of Complaint) further states unequivocally that the Depreciation reserve "cannot be used for the payment of dividend or any other purpose" than that for which it is specifically created.

(Sd.) Andrew Sangster.

Sworn and subscribed to before me this 29th day of January, 1925. (Sd.) Edward C. Ryder, Notary Public. Notary Public for Queens County. Certificate Filed in New York County. New York County Clerk's No. 321. Register's No. 5274. My Commission Expires March 30, 1925. (Seal.)

[fol. 130a] EXHIBIT A. S. No. 1 TO AFFIDAVIT OF ANDREW SANGSTER

AT A GENERAL SESSION OF THE INTERSTATE COMMERCE COMMISSION HELD AT ITS OFFICE, IN WASHINGTON, D. C., ON THE 10TH DAY OF DECEMBER, 1912.

The subject of a Uniform System of Accounts to be prescribed for and kept by telephone companies being under consideration, the following order was entered:

It is ordered, That the Uniform System of Accounts for Telephone Companies with the text pertaining thereto, embodied in printed form to be hereafter known as First Issue, a copy of which is now before this Commission, be, and the same is hereby, approved; that a copy thereof duly authenticated by the Secretary of the Commission be filed in its archives, and a second copy thereof, in like manner authenticated, in the office of the Division of Carriers' Accounts, and that each of said copies so authenticated and filed shall be deemed an original record thereof.

It is further ordered, That the said Uniform System of Accounts for Telephone Companies with the text pertaining thereto, be, and the same is hereby, prescribed for the use of telephone companies having annual operating revenues exceeding \$50,000, subject to the provisions of the act to regulate commerce as amended, in the keeping and recording of their accounts; that each and every such carrier and each and every receiver or operating trustee of any such carrier be required to keep all accounts in conformity therewith; and that a copy of the said First Issue be sent to each and every such carrier and [fol. 131] to each and every receiver or operating trustee of any such carrier.

It is further ordered, That any such carrier or any receiver or operating trustee of any such carrier may subdivide any primary account in the said First Issue established (as permitted in the general instructions contained in the said First Issue); or may make assignment of the amount charged to any such primary account to operating divisions, to its individual lines, or to States: Provided, however, That such subprimary accounts set up or such assignments made by any such carrier or by any receiver or operating trustee of any such carrier do not impair the integrity of the accounts hereby prescribed.

It is further ordered, That in order that the basis of comparison with previous years be not destroyed, any such carrier or any receiver or operating trustee of any such carrier may, during the twelve months from the time that the said First Issue becomes effective, keep and maintain, in addition to the accounts hereby prescribed, such portion or portions of its present accounts as may be deemed desirable by any such carrier, or by any receiver or operating trustee thereof, for the purpose of such comparison; or, during the same period, may maintain such groupings of the primary accounts hereby prescribed as may be desired for that purpose.

It is further ordered, That any such carrier or any receiver or operating trustee of any such carrier, in addition to the accounts hereby prescribed, may unless otherwise ordered, keep any temporary or experimental accounts the purpose of which is to develop the efficiency of operation. Provided, however, That such temporary or experimental accounts shall not impair the integrity of any primary account hereby prescribed.

It is further ordered, That January 1, 1913, be, and is hereby, fixed as the date on which the said First Issue of the Uniform System of Accounts for Telephone Companies shall become effective.

By the Commission:

John H. Marble, Secretary.

[fol. 132] EXHIBIT A. S. No. 2 TO AFFIDAVIT OF ANDREW SANGSTER

Sec. "23. Depreciation of Plant and Equipment.—Telephone companies should include in operating expenses depreciation charges for the purpose of creating proper and adequate reserves to cover the expenses of depreciation currently accruing in the tangible fixed capital. By expense of depreciation is meant—

(a) The losses suffered through the current lessening in value of tangible property from wear and tear (not covered by current repairs).

(b) Obsolescence or inadequacy resulting from age, physical change, or supersession by reason of new inventions and discoveries, changes in popular demand, or public requirements, and

(c) Losses suffered through destruction of property by extraordinary casualties.

The amount charged as expense of depreciation should be based upon rules determined by the accounting company. Such rules may be derived from a consideration of the company's history and experience. Companies should be prepared to furnish the Commission, upon demand, the rules and a sworn statement of the facts, expert opinions, and estimates upon which they are based.

The estimate for depreciation of physical property should take into account—

(a) The gradual deterioration and ultimate retirement of units of property which may be satisfactorily individualized, such as buildings, machines, valuable instruments, etc., to the end that by the time such units of property go out of service there shall have been accumulated a reserve equal to the original money cost of such property plus expenses incident to retirement less the value of any salvage.

(b) The depreciation accruing in property which can not be readily individualized, such as pole lines, wires, cables, or other continuous structures, where expenditures for repairs or replacements of individual parts ordinarily are not actually made until the later years of the life in service of such property, and when made may, therefore, be classed as extraordinary repairs.

The rate of depreciation should be fixed so as to distribute, as nearly as may be, evenly throughout the life of the depreciating property the burden of repairs and the cost of capital consumed in operations during a given month or year, and should be based upon the average life of the units comprised in the respective classes of property.

The amount estimated to cover the expense of depreciation of fixed capital should be charged monthly to account No. 608, "Depreciation of Plant and Equipment" (or to the appropriate clearing account or accounts), and concurrently credited to account No. 102, "Reserve for Accrued Depreciation—Cr."

Account No. 413, "Realized Depreciation not Covered by Reserves," is provided in the Corporate Surplus or Deficit account for charges for realized depreciation on tangible fixed capital retired when such depreciation occurred prior to the establishment of account No. 102, "Reserve for Accrued Depreciation—Cr.," or has not been provided for by credits to that account."

Sec. "24. Extraordinary Casualties and Unanticipated Reconstruction.—If so authorized, upon application to the Commission, the [fol. 133] company granted such authority may charge the amount named in the authorization to a suspense account for the purpose of distributing over a limited period an extraordinary loss of such a nature that it can not be anticipated by the exercise of reasonable prudence. Losses of this sort may be due to the requirement by lawful authority or public necessity of improvements involving the abandonment of a considerable portion of plant and equipment before it has attained its normal life in service, or to an extraordinary

casualty entirely unforeseen and unprovided for. The original cost of the property so abandoned or destroyed should be credited to the fixed capital accounts in which it was carried, and such portion of the cost as may be authorized by the Commission may be charged to the suspense account, the remainder of the cost, less any salvage, being charged out as elsewhere provided in case of retirements of property. The suspense account so raised should be credited and account No. 609, "Extraordinary Depreciation," debited monthly with such an amount as will, through its regular application, amortize the amount of the loss at the end of the period designated.

All ordinary casualties (those which occur with such frequency that the principles of insurance are applicable thereto) should be provided for through an insurance reserve maintained for such losses or be included in the provision for depreciation of plant and equipment."

[fol. 133a] EXHIBIT A. S. No. 3 TO AFFIDAVIT OF ANDREW SANGSTER

"Interstate Commerce Commission, Washington

March 18, 1920.

To all carriers concerned:

Section 435 of the Transportation Act, 1920, contains the following provision:

The Commission shall, as soon as practicable, prescribe, for carriers subject to this Act, the classes of property for which depreciation charges may properly be included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose. The Commission may, when it deems necessary, modify the classes and percentages so prescribed. The carriers subject to this Act shall not charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the Commission. No such carrier shall in any case include in any form under its operating or other expenses any depreciation or other charge or expenditure included elsewhere as a depreciation charge or otherwise under its operating or other expenses.

Information received by the Commission indicates the existence of doubt as to the propriety of carriers making any charges to operating expenses with respect to depreciation prior to such time as the Commission shall prescribe the specific percentages of depreciation [fol. 134] which shall be charged.

The purpose of this curricular is to dispel any such doubt as may exist in the minds of accounting officers.

Until the Commission shall otherwise order, all carriers subject to the Act to regulate commerce should continue to observe the requirements respecting the accounting for depreciation which are embodied in the effective accounting classifications prescribed by the Commission for the respective classes of carriers.

George B. McGinty, Secretary."

[ol. 135]

IN UNITED STATES DISTRICT COURT

[Title omitted]

AFFIDAVIT OF HENRY R. GABAY—Filed Jan. 25, 1925

STATE OF NEW YORK,

County of New York, ss:

Henry R. Gabay, being duly sworn, deposes and says:

I was graduated from Cornell University, Class of 1897, with the degree of Mechanical Engineer in Electrical Engineering.

I have been employed continuously for more than twenty-six years by the New York Telephone Company, the plaintiff herein, in commercial engineering and plant engineering. Since 1913 I have been Commercial Engineer and General Commercial Engineer, which latter position I now hold.

I have charge of the making of rate schedules and the preparation of studies in relation thereto and the study of the effect of rates on the revenues of the Company.

I am familiar with the rates and charges made by plaintiff for telephone service and facilities furnished by it and with the schedules of such rates which are now and have been from time to time filed by plaintiff with the Board of Public Utility Commissioners of the State of New Jersey.

The plaintiff renders in the territory within which it operates in the State of New Jersey both telephone exchange service and telephone toll service. Telephone exchange service is service between telephone stations within the same local service area, and telephone toll service is telephone service between telephone stations located in different local service areas. The territory in the State of New Jersey in which the plaintiff operates is divided into a number of local service areas. The telephone exchange service and the intrastate telephone toll service together constitute the whole of plaintiff's telephone service between points within the State of New Jersey.

Plaintiff's rates for telephone exchange service which are now in effect, and which the order of the defendants complained of in this suit prescribes shall be continued in effect from and after January 1, 1925, have been in effect continually for upwards of ten years, except that some reductions in certain of the former exchange rates were made in the years 1914 and 1915, and some increases in certain of such former rates were made in the year 1919, during the

period when plaintiff's property was in the possession and under the control of the United States Government. Such changes in the [fol. 136] rates during said ten year period have been very few in number and the amount of revenue effected thereby has been relatively unimportant. Also, the reductions made have offset all increases in the effect upon the revenues of the plaintiff. The exchange rates considered as a whole now in effect are somewhat lower than the exchange rates in effect in 1914.

Substantially the same rates for intrastate telephone toll service have been in effect for upwards of ten years, with the exception that a somewhat lower schedule of toll rates was in force from July 1, 1918, to January 21, 1919, inclusive.

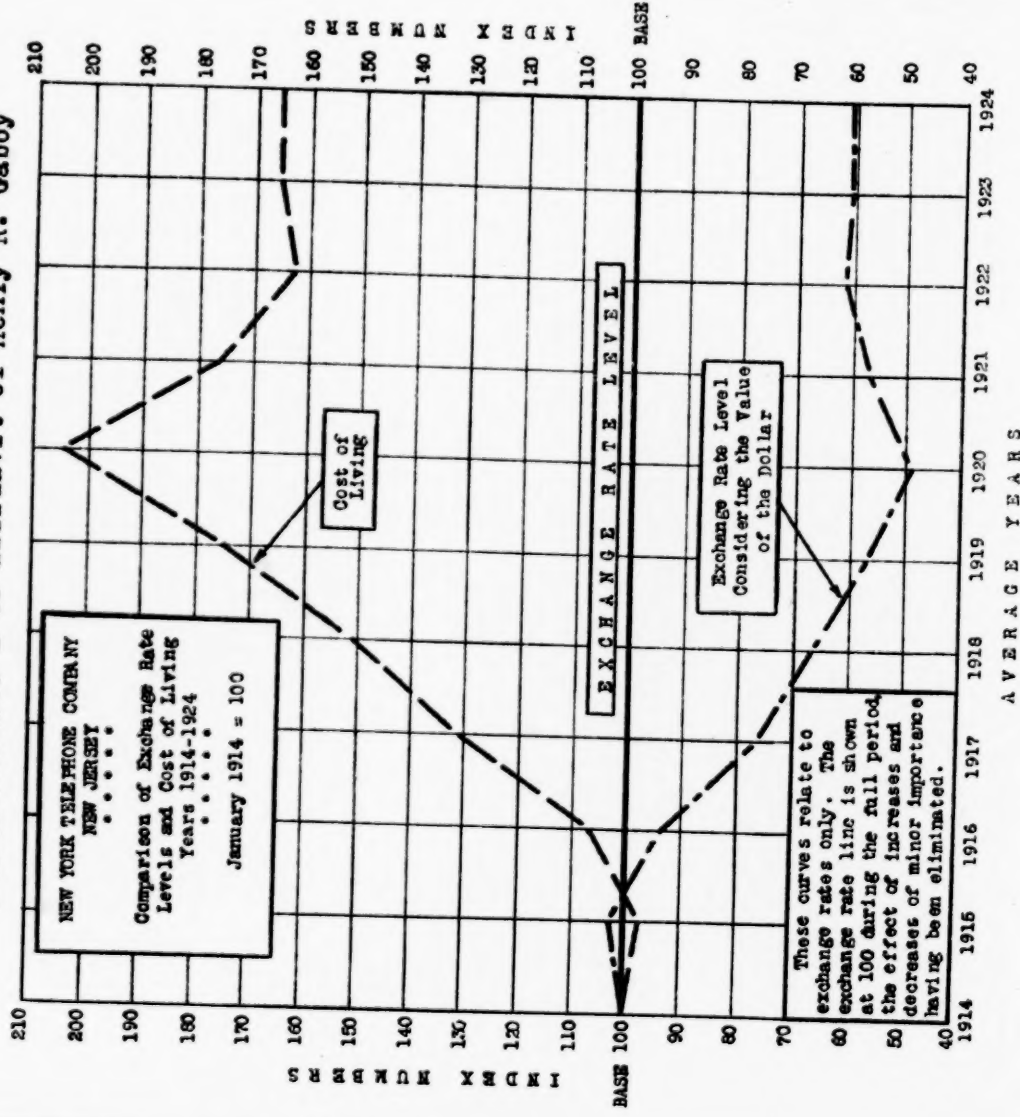
I have read the attached affidavit of Henry C. Carpenter verified the 29th day of January, 1925, and am familiar with the estimate of revenues of plaintiff for 1925 under the existing rates as stated in said affidavit. I participated in the preparation of said estimate and in my opinion it is fair and reasonable.

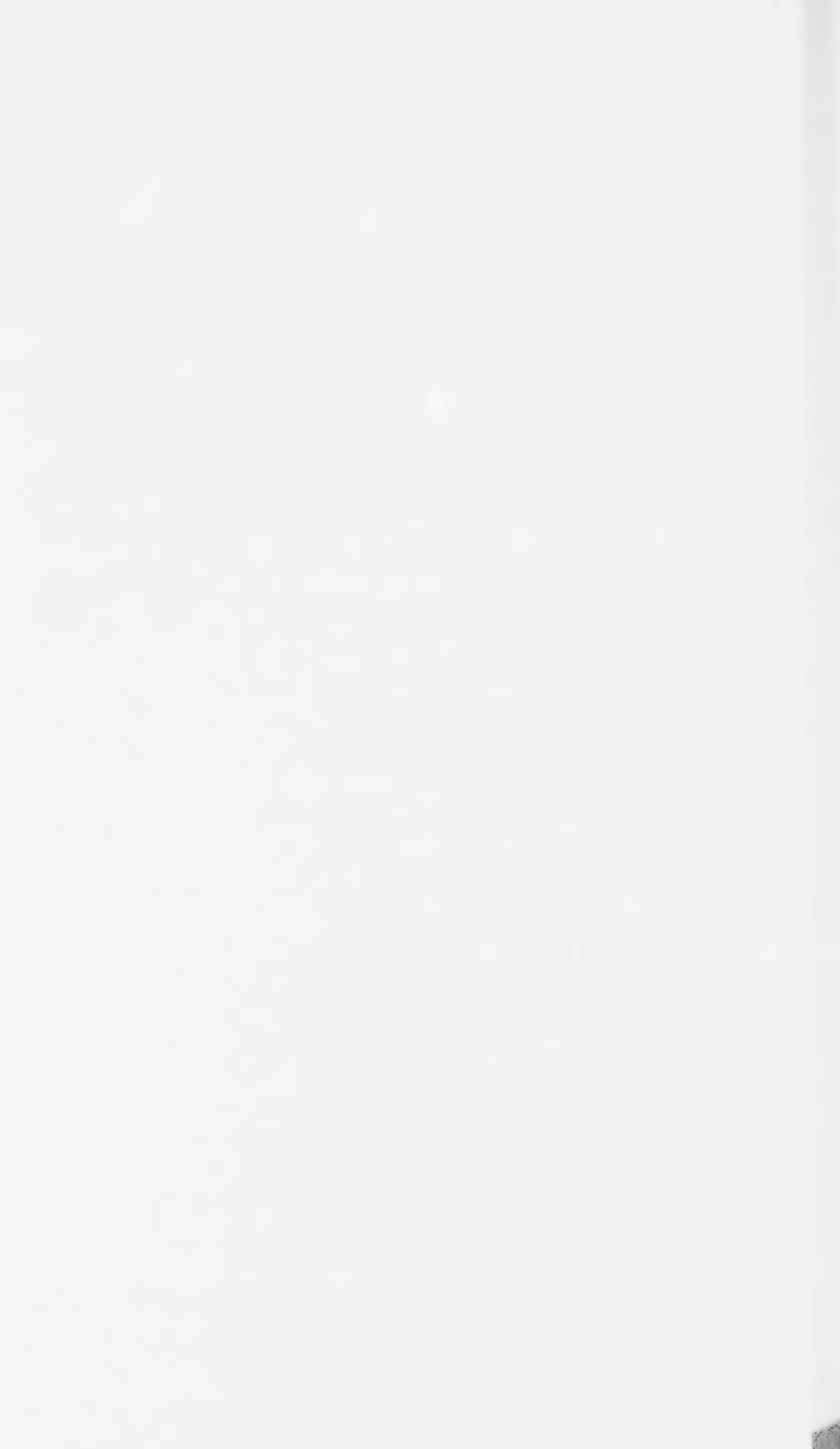
I am familiar with the rates for exchange service in New Jersey filed by plaintiff with the defendants on March 6, 1924, which were the subject of the investigation by the Board of Public Utility Commissioners which resulted in the order complained of in this suit and I estimate that the charging of such rates would, upon the basis of plaintiff's present subscribers, increase the plaintiff's net revenue by the amount of approximately \$2,300,000 annually. I am of the opinion, based upon my knowledge of telephone rates and the studies that I have made, that the said rates so filed are less than the value of the service and that said rates are fairly adjusted as between the different classes of service and would if put in force and combined with the rates for toll service both interstate and intrastate produce a net revenue of less than 8% on the value of plaintiff's property as found by said Board.

In accordance with the terms of the contracts for telephone service made by the plaintiff with its several subscribers and the established practice of the plaintiff which has been in effect for many years, bills are mailed each month to subscribers on or about the first day thereof. Such bills include advance charges for exchange service and facilities to be furnished during the said month. In ordinary course only one bill for telephone charges is sent each month by the plaintiff to each of its subscribers.

I have made a study for the purpose of making a comparison between the levels of rates charged by plaintiff to subscribers for telephone service in the State of New Jersey and the purchasing power of the dollar as determined by the cost of living. For this purpose I have used as a source of information for obtaining living costs the statistics prepared by the United States Bureau of Labor Statistics. As stated above in this affidavit, the exchange service rates of plaintiff in the State of New Jersey have been substantially unchanged for more than ten years and are, therefore, at practically the same level at the present time as in 1914. The cost of living, as obtained from the statistics above referred to, is more than 60% higher at the present time than it was in 1914 and it has been approximately at

EXHIBIT H.R.G. 1 to affidavit of Henry R. Gaboy





this level during the years 1922, 1923 and 1924. I have shown the result of this study graphically upon a chart hereto annexed, and made a part of this affidavit and marked "Exhibit H. R. G. 1", on which the following facts are shown: 1914 is used as the base and is [fol. 137] treated as 100%. The levels of rates for exchange service having been substantially the same through the ten years the rate level curve is coincident throughout the chart with the base line. The curve showing the cost of living is taken from the sources as above stated. The curve showing the exchange rate level considering the value of the dollar, which is plotted below the base line, is the result of computing the value of the dollar by using the cost of living figures shown above the base line; e. g., in 1924, the cost of living being approximately 165% of the cost in 1914, \$1.65 was required to purchase what \$1 would have bought in 1914, or the purchasing power of \$1 was slightly above the purchasing power of 60 cents in 1914. As there has been no substantial change in the rate level the study shows that plaintiff's rates for exchange service in 1924 were, in terms of the purchasing power of the dollar, at a level of about 60% of that which obtained in 1914.

The curves on this chart being based on average figures for a given year do not show minor fluctuations.

The decrease in the purchasing power of the dollar is reflected in the increased cost of labor, which constitutes the largest portion of plaintiff's operating expenses. As shown by the affidavit of Jesse A. Moir, annexed hereto, the wages of plaintiff are on a level more than 65% higher than the level of 1914.

(Sd.) Henry R. Gabay.

Subscribed and sworn to before me this 29th day of January, 1925. (Sd.) Edward C. Ryder, Notary Public. Notary Public for Queens County. Certificate Filed in New York County. New York County Clerk's No. 321. Register's No. 5274. My Commission Expires March 30, 1925. (Seal.)

(Here follows Exhibit H. R. G. 1, marked side folio pages 138 and 139)

[fol. 140] IN UNITED STATES DISTRICT COURT

[Title omitted]

AFFIDAVIT OF TAGE P. SYLVAN—Filed Jan. 25, 1925

STATE OF NEW YORK,
County of New York, ss:

Tage P. Sylvan, being duly sworn, deposes and says:

I reside in Montclair, New Jersey. I am Vice President of New York Telephone Company, the plaintiff herein. I was employed in the Bell System of telephone companies in 1898 in the middle west and have been continuously employed by the Bell System telephone companies since that date. In 1910 I came into the employ of the plaintiff and in 1912 became Assistant to the then Operating Vice President of that Company, Mr. F. H. Bethell, who was also President of The Bell Telephone Company of Pennsylvania, The Chesapeake and Potomac Telephone Company and Associated Companies. In 1920 I became Vice President of the plaintiff. Among my duties I am charged with the scrutiny of the relationship between the American Telephone and Telegraph Company and the plaintiff and between the Western Electric Company and plaintiff. I am thoroughly familiar with the contracts existing between the plaintiff and the two above-named companies and with the relations out of which such contracts grew. Prior to the execution of the license contract now in effect between the American Telephone and Telegraph Company and plaintiff I was requested by the said Mr. F. H. Bethell to make a study with a view to recommending whether or not it should be executed by plaintiff and the companies of which Mr. Bethell was at that time President.

In pursuance of the investigation made by me under Mr. Bethell's direction I examined all the original contracts, all the letters and memoranda concerning the relations covered by or specifically set forth in the proposed contract. I interviewed our operating officials; I visited the research laboratories maintained by and for the Bell System, also the manufacturing plant of the Western Electric Company; I obtained information as to the development of telephone systems in other countries. As a result of this investigation I recommended very strongly the execution of the contract by the plaintiff.

On June 18, 1920, the plaintiff herein executed the contract and is now bound by the terms thereof. The amount paid thereunder is fixed by its terms and the services rendered thereunder could not be obtained from any other source nor upon any other terms except [fol. 141] those provided in said contract.

The present relationship grew out of the original licenses granted by the American Bell Telephone Company, the predecessor of the American Telephone and Telegraph Company, to certain persons or corporations to use the original Bell patents within certain specified territories set out in such licenses. The policy of the American

an Bell Telephone Company, which owned such patents, was to lease rather than sell the patented instruments. The original licenses were made at a time when telephone apparatus was simple and telephone service undeveloped. With the growth of the telephone business there came a greater complexity in the apparatus and facilities used in rendering service, so that the present telephone system consists of highly improved and extraordinarily complex apparatus protected by numerous patents. As the licensor of the instruments under the original license contracts, the American Bell Telephone Company furnished services and advice as to the use of the instruments and other apparatus connected therewith. A rental was charged for the instruments, of \$14.04 for a set consisting of a receiver and a transmitter, and no charge additional thereto was made for licensor's advice and services. As telephone apparatus grew from its original condition, which was little more than two sets of instruments and a connecting wire, to the present plant comprising buildings, immense switchboards, underground and overhead cable and wire systems as well as the greatly improved instruments and other apparatus located on the subscribers' premises, the services grew correspondingly coming to include not only research in the art of telephony that advice and aid to the licensees as to operating and construction methods and numerous other services. The relationship continued under the old license contracts although the scope of the services furnished was greatly enlarged. There were from time to time reductions in the amount of the annual rental per instrument, the amount of the rental being graduated to bear a relation to the rate charged for service. This arrangement while producing a reduction in the rental charged the New York Telephone Company necessitated keeping detailed and elaborate accounts with each group of subscribers. In the year 1902 a new basis was established by which the American Telephone and Telegraph Company furnished to the licensee companies as many instruments as they might require and continued to furnish the services which had grown up in connection with the license arrangement but the method of compensation was changed from the basis of a graduated rental per instrument to a percentage of the gross receipts of the licensee company, this percentage being fixed at $4\frac{1}{2}\%$. This method of payment has continued to the present time. The effect was to make the annual payment per set of instruments lower than previously and to greatly simplify the accounting necessary. At the present time the total annual payment by plaintiff in New Jersey when divided by the average number of sets in service amounts to about \$2.78 as compared with the original rental of \$14.04. The present contract executed on June 18, 1920, as aforesaid was declaratory of the conditions previously existing.

A copy of said contract is annexed hereto and marked Exhibit T. P. S. No. 1.

[fol. 142] The services furnished by the American Telephone and Telegraph Company to the plaintiff and other licensee companies extend to every branch of the telephone business. A general classification of the services may be made as follows:

1. Rental of Instruments and Instrument Services.

Under this classification the American Company furnishes the plaintiff all of the transmitters, receivers and induction coils used by the associated company in giving telephone service and undertakes the repairs and maintenance of such instruments. The supply of instruments furnished to the plaintiff include not only those used by subscribers but those used by the company in its own operations such as operators' sets, testers' sets, and an adequate supply to be kept on hand by the plaintiff to provide for the growth of the business. In addition to the supply of instruments kept on hand by the plaintiff company the American Company is bound under the agreement to carry an adequate reserve stock sufficient to assure the plaintiff and other operating companies of an uninterrupted supply of instruments. Whenever improvements in the type of instrument are made the plaintiff may return its instruments of an older type and without additional charge obtain the improved type of instrument. As a result of this arrangement neither the plaintiff nor any operating company has an incentive to retain obsolete or inferior types of instrument in service for reasons of economy. No specific charge is made for the instruments and no royalty is charged for any patented device used in such instruments. Included with such instrument service is the use, free of specific charge and free of all payments of royalty, of the patented device known in telephony as the repeater. By means of this device it has been possible to secure transmission over great distance without increasing unduly the size of the conductors.

2. Development and Research.

The American Company maintains a large staff of experts and engineers exclusively engaged in research work in the art of telephony. The work of this department consists not only of studying and developing ideas and inventions of the research staff but also investigation and examination of inventions and devices of persons outside of the employ of the American Company or of other Bell System companies for the purpose of determining whether such inventions or devices would be useful in telephony. If such inventions or ideas are found to be useful or practicable the department of Research and Development does such work as may be necessary to adapt them to the use of the telephone business. For example:—A device which has resulted in the saving of millions of dollars per annum to the Bell System and consequently to the public is the so-called "loading coil." This device was based upon an invention or patent of Professor Michael Pupin. His invention, however, when made was in the nature of a mathematical formula and not at that time adapted to practical use in the telephone art. The use of the patent for telephone purposes was acquired by the American Company from Professor Pupin upon the advice of the research engineers of that company and the patent so acquired was made use of in developing the so-called "loading coil." The load-

[fol. 143] ing coil passed through several stages of improvement before reaching its present form. Through this device it is possible to provide a high grade of transmission without the use of large conductors.

Through the work of this department there have resulted the use of many improvements in telephony among which may be mentioned the antimony sheath cable, the quadded cable, the carrier current, the phantom circuit, the repeater, the fine wire cable, and other inventions and devices which have made possible great reductions in the cost of giving telephone service and increasing its efficiency. In addition said department has made improvements and inventions in the types of telephone instruments and in the central office switchboards which have been of the greatest importance not only in improving the character of the service but in the saving to the operating companies of substantial amounts of money in annual charges. The Development and Research Department makes experiments and investigations to determine the best method of prevention of electrolysis also to determine the suitability of various kinds of materials such as poles, subway materials, pole line hardware, etc., in the telephone business. It has made important investigations as to methods of avoiding electrical interference from high tension wires of power and light companies and railroad companies. It is my opinion that the work of this department has been of incalculable value in developing the telephone art to its present state of efficiency and that the research work could not have been as effectively done by independent units conducting their researches in relatively small areas. The ability to get satisfactory results from such investigations has been enhanced by the fact that the American Company could make tests throughout the country under all climatic and service conditions which would be impossible were an independent unit such as plaintiff to attempt to perform such work.

3. Patents.

The American Company through the work of the department of Research and Development and through the acquisition of patents recommended by that department is the owner of upwards of four thousand patents related to the telephone art. These patents are developed and acquired without any specific expense to the plaintiff or other licensee companies. The use of all such patents is given to the plaintiff and other licensee companies without payment of any royalties or without charges of any kind. The American Company furthermore is obligated under this agreement to protect and defend the plaintiff from all actions or suits charging infringement of patents and to save them harmless against the results of any such actions. As a result of this service the plaintiff has not only the use of all patents above referred to without royalty but is relieved of the expense of maintaining a department for the acquisition of patents, the defense of patent suits or the prosecution of such suits.

4. Department of Operation and Engineering.

The work of this department is of a manifold character. Telephone engineering may be classified as follows—

- A. General Engineering.
- B. Plant Engineering.
- C. Traffic Engineering.
- D. Commercial Engineering.

[fol. 144] The work of this department of the American Company includes not only advice to the plaintiff and other licensee companies on specific problems which may arise but also general studies and investigations of engineering and operating methods under all conditions and the issuance of circulars, hand-books, bulletins, specifications to be made use of by the licensee companies in the operation of their systems. The work of this department relieves the plaintiff not only of making studies but of the compilation and publication of hand-books and routines for the use of the operating and construction forces and it is enabled through the work done by the department of Operation and Engineering to get the benefit of country-wide experience in matters of engineering and operation which it would not otherwise have..

5. Accounting Services.

Similar services are furnished by the Accounting Department of the American Company based on general studies of accounting methods and on country-wide experience. There is also maintained a department for the compilation of and furnishing to the plaintiff and other licensee companies statistics useful to plaintiff in the operation of its business. This department also makes settlements with other companies covering inter-company toll service and it maintains a staff to represent this and other associated companies before such national bodies as the Interstate Commerce Commission, Internal Revenue Department, the Bureau of Standards and other governmental and national bodies. This department also periodically audits the accounts of the plaintiff company.

6. Financial Assistance.

Under the contract the American Company agrees to furnish to whatever extent its finances and credit may permit advice and assistance in financing. Through the financial service rendered by the American Company the plaintiff has been enabled for several years last past to borrow many millions of dollars on open account from the licensor company paying therefor an average annual interest rate of 5.88%, the sums of money being furnished in such amounts as plaintiff required at a given time. Through this service the plaintiff was relieved of the necessity of borrowing in the open market at higher rates of interest and the financing for a given period by the issuance of securities in much larger amount than would have been necessary for present requirements.

7. Miscellaneous Services.

In addition to the above mentioned services plaintiff company receives advice and assistance on legal and publicity matters and on the administration of its Employees Benefit Fund and on many other matters connected with its operations and business.

8. The plaintiff has the right to connect and exchange services with all other companies in the Bell System. As a result of this provision of the contract country-wide inter-communication by telephone is assured to every licensee company.

A result of the relationship between the licensor and licensee companies has been to secure standardization of equipment and methods by the several operating companies comprising the Bell System. Without such standardization it would be impossible to secure the same efficiency of transmission.

[Vol. 145] It is my opinion after years of observation and study of the operation under the so-called license agreement that the supremacy of the telephone system of this country and the success which has attended the operation of the New York Telephone Company can in the main be traced to the existence of the relation established and maintained under such agreement.

As a test of reasonableness of the 4½% charge it is my opinion from my own knowledge and belief and as a result of consultation and discussion with the officials and department heads of the New York Telephone Company, that should this relation be terminated we should first suffer a serious set-back and diminution in the progress of the art of telephony and secondly a substantial increase in our cost of operation, for we should at once be required to establish new departments and engage in new activities not now necessary.

We should have to establish a patent department, a research department, a testing department, a laboratory. We should have to enlarge the engineering, traffic, plant, commercial, accounting, legal, personnel, benefit fund, medical and financial departments so as to undertake studies experiments and services not now required because of the work of the American Telephone and Telegraph Company available and furnished under the license agreement. All departments would be required under the changed conditions to expend large amounts of time and money in visitation to and conference with other telephone companies if any co-ordination of and consistency in general practice were to be attempted.

Mindful of the fact that the New York Company as one of similar companies operating with the American Telephone and Telegraph Company could not justify anything like the large and effective staff and works of the American Telephone and Telegraph Company, the minimum immediate, necessary and feasible enlargement of its staff and activities and the expense incident thereto would cost at the outset not less than three million three hundred thousand dollars (\$3,300,000.00) per year.

Any termination of the present arrangement would also necessitate the purchase by the New York Company of instruments to replace those now furnished by the American Telephone and Telegraph

Company under the license agreement. The added expense to the New York Company in form of annual carrying charges on such instruments with the necessary surplus stock required would amount to at least one dollar per station, or a total as of December 31, 1924 of two million two hundred and fifty thousand dollars, (\$2,250,000.00).

Under the present arrangement no charge is made for royalties on patents owned by the American Telephone and Telegraph Company. Under a changed condition it is my opinion that at least 5% would be added to the price of material and apparatus now purchased, royalties for patents and patented processes. This on the basis of purchases for the year 1924 would add \$1,961,000 to the cost of such material.

With the breaking up of the present system of uniform standards and apparatus throughout the Bell System which would inevitably follow setting up independent research and development work in the separate companies, quantity production and purchases as now [fol. 146] practiced in the Bell System would largely disappear. In place of one standard and best way, each telephone company and manufacturer would develop its own standards. Incident to such change and judging by the relative prices now charged by the Western Electric Company, it is my firm opinion that prices for apparatus and material would increase not less than 10% over the now prevailing. On the basis of purchases made by the New York Telephone Company in the year 1924 this increase would amount to \$4,486,000.

Under the license agreement the American Telephone and Telegraph Company assists us in our financing operations by advice and counsel, and from time to time they advance to the New York Telephone Company money on open account or on notes pending permanent financing operations. The charge for such money is at the rate of 5.88% and no loss is incurred by the New York Company because of money remaining idle. The usual practice is to obtain money needed on last day of current month and immediately use same in payment of bills or obligations. Were the present relation to change it would be necessary to arrange for financing in advance at least to the extent of annually issuing bonds or stocks to cover the year's requirements.

note and stock

On the most favorable basis of bond ^{note and stock} issues the average cost including underwriting, taxes, preparation (Sd. T. P. S. (ECR)) of bonds, etc., would be not less than 6½%. Pending use of money so obtained the most that could be realized on short term securities purchased or from banks would be 3½%. This would represent a loss to the Company of 3% pending use of money. On the basis of present requirements of \$50,000,000 annually the cost of money at 6½% would represent \$3,250,000 against which the earnings pending use would be at rate of 3½% \$875,000 considering six months as average period which money would be loaned out. This would make the net cost to the Company \$2,375,000.

Under present practice of obtaining money from the American Telephone and Telegraph Company as needed at 5.88% and on the basis of \$50,000,000 in use an average of six months the cost would be \$1,470,000 representing a saving of more than \$900,000 for the year.

This partial list of increased cost in operation which I believe would result from a termination of the present arrangement and which may be considered as one test of the reasonableness of the 4½% charge, totals \$12,897,000.

In tentatively setting up a relatively small organization and activities which I believe it would be absolutely necessary to create in the event of a termination of the present arrangement the organization would only be sufficient to keep the New York Telephone Company abreast of the art of wire telephone communication. It would be no more than a company as large as this would need for this purpose. If, for example, an entirely new machine switch system, or some new device for improving transmission, comparable to loading or the telephone repeater were invented either inside or outside the proposed organization, the tentative organization set up is not nearly sufficient to develop the invention and fit it to the conditions of the New York Telephone Company's territory. Similarly, while three or four men are provided to observe the progress in the field [fol. 147] of wire telegraphy and of radio, no organization has been provided for continuous research and development in these fields, and the company's future interest in these branches of the communication art would not be safeguarded.

In setting up the tentative organization no addition to the executive staff has been provided through the necessity of covering this new activity and dealing with other companies and larger problems would doubtless call for a substantial increase in executive staff.

Having in mind the many features not covered and the serious setback to telephone progress which I believe would flow from such a change as I have outlined and from the resultant lessening in present activities under the license agreement under which for the year 1924 we paid to the American Telephone Company \$6,034,026, and believing that the limited substitute service I have set up would cost the New York Telephone Company more than twice as much I reiterate my statement that the so-called license agreement with the American Telephone and Telegraph Company represents a valuable agreement, and that measured by the cost and results obtained from a vastly inferior service which would follow our attempt to perform such of the service as we could perform, the charge to the New York Telephone Company is not only reasonable but extremely low.

Applied to the New York Company's operation in New Jersey the amount paid to the American Telephone and Telegraph Company under the 4½% license agreement for the year 1924 was \$951,042, whereas the apportionment to New Jersey of the cost of the organization and incident expense as hereinbefore set forth would be \$2,032,567.

As another test of the reasonableness of the 4½% payment I have made a calculation of the savings to the plaintiff in the first cost of

its plant in the State of New Jersey and in annual charges attributable to its operations in that State which have been effected by a few easily selected improvements in the telephone art developed through the work of the General Staff of the American Telephone and Telegraph Company and received by plaintiff among the benefits derived from the relationship existing under the License Contract. The figures are shown in the following table and are applied to plant quantities as of December 31, 1923:

Reduction in Plant Costs of Property of the New York Telephone Company in State of New Jersey Resulting from Certain Development Work Carried Out by the General Engineering Staff of the American Telephone & Telegraph Company

	Saving in first cost	Saving in annual charges
22 gauge cable, sizes up to and including 600-pair, including saving in ducts....	3,238,300	430,500
900-pair 22 gauge and 1,200-pair 24 gauge including saving in ducts.....	646,750	76,600
24 gauge cable (900-pair and smaller)....	39,430	5,800
Lead-Antimony Sheath	414,980	58,000
Quadded cable including saving in ducts..	990,500	134,350
Open Wire phantom circuits including Pole Line and Right of Way.....	1,494,240	261,400
#17 Gauge Outside Distributing Wire....	308,500	65,000
Loading Coils:		
(a) On cable circuit including saving in ducts, poles and right of way.....	50,391,300	6,252,400
(b) On aerial wire circuits.....	236,900	33,880
Total	57,760,900	7,317,930

The saving in annual charges to plaintiff in New Jersey alone in [fol. 148] the year 1923 from the few developments in the art above enumerated is, as shown above, \$7,317,930 as compared with the license payment to the American Telephone and Telegraph Company in that year of \$851,331.

As an officer of plaintiff company, with full knowledge of the relationship established by this contract and the benefits derived therefrom, I am of the opinion:

First. That the services rendered thereunder are necessary to plaintiff in the operation of its business.

Second. That such services could not be obtained from any source other than the American Telephone and Telegraph Company.

Third. That such services could not be performed by the plaintiff company without large and costly additions to its forces and equipment and if so performed the services could not be as extensive or as valuable as those rendered under the existing relationship.

Fourth. That the cost to plaintiff company of performing these services would be much greater than the amount paid to the American Telephone and Telegraph Company under the terms of the contract.

Fifth. That the payments by the plaintiff under the contract are very reasonable and less than the value of the services received.

Sixth. That the present arrangement under the license agreement by which the American Telephone and Telegraph Company, with its large and complete staff of experts, laboratories and consultants outside of its own staff, performs for all of the companies comprising the Bell System the fundamental research, development and general engineering work is the most economical and efficient arrangement possible. Were the New York Telephone Company to set up its own organization as hereinbefore set forth the logical conclusion would be that each of the other companies in the Bell System would be compelled at a greatly increased cost to do likewise, resulting in twenty-eight separate organizations and laboratories performing the work now done by the one. Co-ordination and uniformity would be obviously impossible and manifestly, as above set forth, the cost to all the associated companies and to each of them would be far in excess of the amounts now paid in form of license charges. To substitute for the work done by a central organization the inferior efforts of twenty-eight separate units at greater cost is an economic waste.

(Sd.) Tage P. Sylvan.

Subscribed and sworn to before me this 29th day of January, 1925. (Sd.) Edward C. Ryder, Notary Public. Notary Public for Queens County. Certificate Filed in New York County. New York County Clerk's No. 321. Register's No. 5274. My Commission Expires March 30, 1925. (Seal.)

[fol. 149] EXHIBIT No. T. P. S. 1 TO AFFIDAVIT OF TAGE P. SYLVAN

Agreement Between American Telephone and Telegraph Company and New York Telephone Company Covering Telephones, Services, Licenses and Privileges

Memorandum, dated this eighteenth day of June, 1920, stating and reaffirming the contractual relations now and heretofore existing between the parties hereto in connection with the furnishing of telephones and licensing their use, and the licensing of telephonic apparatus suitable for use in connection therewith, and the furnishing of various services and privileges, by the American Telephone and Telegraph Company, a corporation organized under the laws of the State of New York, hereinafter called the "Licensor," to the New York Telephone Company, a corporation organized under the laws of the State of New York, hereinafter called the "Licensee."

Whereas, the Licensee is now and heretofore has been conducting a telephone business within the territory hereinafter defined, as a part of the Bell System, under certain license contracts in Forms 109 D, for Exchanges, 113 D, for Extra-Territorial Connecting Lines, and 116 C, for the supply of Telephones for Private Lines and Other Purposes, each dated January 6, 1883, from The American Bell Telephone Company, a corporation organized under the laws of the Commonwealth of Massachusetts, as the owner of Letters Patent of the United States granted to Alexander Graham Bell March 7, 1876, and January 30, 1877, numbered 174,465 and 186,787, respectively, and as the owner of, or as having the right to use, sundry other inventions which then were or might thereafter be embodied in electric speaking telephones, said license contracts also covering other such inventions which said The American Bell Telephone Company might thereafter own or have the right to use; and,

Whereas, the Licensor, as the successor in interest of said The American Bell Telephone Company in and to said license contracts, has assumed and is now and heretofore has been continuously discharging all of the obligations of said The American Bell Telephone Company under said license contracts; and,

Whereas, by mutual agreement of the parties thereto said license contracts have heretofore been modified in various respects, as shown by letters, by written agreements and by the practice of the parties evidenced by a continued course of dealings between them; and,

Whereas, the Licensor and the Licensee now desire for purposes of convenience to state in one instrument and reaffirm the contractual relations that now exist and have heretofore existed between them in respect to said matters;

Now, therefore, this instrument witnesseth that said contractual relations have heretofore been and now are as follows:

[fol. 150] 1. It is understood that the Licensor and the Licensee, respectively, have succeeded to all the rights and liabilities of the parties to said license contracts.

2. For the purposes of this memorandum:

(a) The word "telephone" means either a magneto telephone or a battery transmitter with induction coil.

(b) An "exchange" means a system in which different stations on the same or different circuits, and either within any city, town, borough or village, or within a radius of fifteen miles of a central office, are connected with such central office or branch offices, for the purpose of placing subscribers or other parties by such circuits in communication with such central or branch offices, or with each other, either directly or through the agents of the system.

(c) An "extra-territorial connecting line" means a line connecting an exchange, as hereinbefore defined, with points without the territory of such exchange and within the territory of the Licensee in order to establish telephonic communication between the patrons of such exchange and parties at such points reached by said line.

(d) A "private line" means a line consisting of only a single circuit both ends of which are located wholly within the territory of the Licensee, which shall not be permanently or temporarily connected with any other circuit, and the telephones on which shall be used only for the individual and private business of the patron and only by him or his employees, and upon which no business shall be transacted for any consideration or toll to be paid by other persons than the patron or other parties named in the lease of telephones, and over which shall be transmitted no messages in respect of which, or of the transmission, collection or delivery of which, any consideration or toll is to be paid by any other person. But no one of the stations of a private line or of the lines of private intercommunicating systems shall be used as an exchange office, or be permanently or temporarily connected with a telephonic exchange system.

(e) A "private intercommunicating system" means an arrangement of equipment consisting of a switchboard or equivalent apparatus with operating telephone and telephone stations connected thereto, providing for telephonic intercommunication between the stations and having no connection with a telephonic exchange system. In other respects, the use is limited as above stated for private lines.

3. The Licensor, at the warehouse of the Western Electric Company, Incorporated, most convenient to the territory of the Licensee and from which the last named company delivers to the Licensee telephonic apparatus, will deliver to the Licensee, as needed, telephones made and to be used under the Licensor's patents, as herein set forth and permitted; the Licensor to keep continuously in stock a sufficient number of telephones to insure prompt deliveries. All telephones delivered to the Licensee shall be deemed to be furnished hereunder unless otherwise specially designated by the Licensor. They will be of such character and pattern and bear such marks as the Licensor shall from time to time determine, but the Licensee may choose from among such standard patterns. Each of said [fol. 151] telephones shall remain the property of the Licensor, and is leased, and the use of each licensed, under all patents under which the Licensor has or may have the right to license, so far as applicable thereto, for the purposes herein declared. The Licensee has the right to use said telephones and to grant such right of use to its patrons or to other parties in its territory, as hereinafter provided, for the purposes and to the extent herein limited, upon condition that and so long as the payments hereunder shall be duly paid to the Licensor and the provisions hereof are not violated, but not longer or otherwise, (1) upon circuits exclusively composed of the lines of any of its exchanges; (2) upon extra-territorial connecting lines whether furnished in whole or in part by or for the Licensee; (3) in connection with the trunk lines reserved to the Licensor by Article 5; (4) with the approval of the Licensor, upon the telephone systems of other parties for use in the territory of the Licensee under and in accordance with its regular sub-license or connecting agreements with such parties; (5) in connection with other telephones, not furnished or licensed by the Licensor, which are used

on farmers' lines, so-called, or lines of a similar character, on lines operated by railroads, and on lines and exchanges operated by sub-licensee or connecting companies and wholly located in the territory of the Licensee and not connected with the lines and exchanges in the territory of any other licensee of the Licensors; provided that all such other telephones shall be of such a type, and the lines upon which they are used shall be maintained and operated at such a standard of efficiency, as will not in the judgment of the Licensee unduly impair the quality of the service furnished over the joint lines of such users and the Licensee; (6) upon private lines and lines of private intercommunicating systems.

The Licensee shall not directly or indirectly connect with the trunk lines reserved to the Licensors by Article 5 any line or telephone exchange, except lines or exchanges which it has been specially authorized by the Licensors to connect with said trunk lines.

All rights not specifically granted to the Licensee remain to the Licensors.

The Licensors will not furnish or license any telephones to be used by others upon an exchange within the territory of the Licensee while its rights hereunder exist, except telephones to be used on the lines of exchanges having their central offices outside the territory of the Licensee by persons within said territory who are or may be subscribers to or patrons of such exchanges; nor will the Licensors furnish or license any such telephones to be used by others upon extra-territorial connecting lines while the rights of the Licensee hereunder exist; provided, however, that the Licensee shall furnish or cause to be furnished exchanges and lines sufficient to satisfy all reasonable demands of the public for exchange and toll line service within said territory and shall furnish such service at rates that are just and reasonable.

This article shall not be so construed as to prevent the Licensors in its discretion from authorizing the Western Electric Company, Incorporated, or its successors and assigns, to sell telephone receivers and transmitters of any type in the open market to all buyers.

[fol. 152] 4. The Licensors will license the use of the inventions in call-bells, switches, switchboards, and other telephonic devices, apparatus, methods and systems needed for the telephone lines of the licensee, which it can so license, upon the same terms for the Licensee as for others under similar circumstances; but such call-bells, switches, switchboards and other telephonic devices, apparatus, methods and systems shall not be disposed of by the Licensee without the consent of the Licensors except to those so licensed by the Licensors to use them or to the licensed manufacturers of the Licensors.

5. The Licensee may enjoy any of the Licensors' rights of way and similar franchises of the Licensors to maintain its lines, which the Licensors can permit it to use, when and so long as, in the judgment of the Licensors, it shall not interfere with the enjoyment thereof by the Licensors or its other licensees, and shall pay whatever may be due to third persons, if anything growing out of or in connection with such use by it, and may, to the extent and under the

conditions aforesaid, use the Licensor's overhead and underground facilities for supporting or carrying wires (both open and in cable) upon paying a pro rata share of the cost of constructing and maintaining them, computed in accordance with the existing practices of the parties, or such other reasonable compensation as may be agreed upon. For trunk lines from the several exchange offices to points outside of the respective exchanges, the Licensor may, without further compensation, enjoy all rights of the Licensee to construct and maintain lines which the Licensee can permit it to use, when and so long as, in the judgment of the Licensee, it shall not interfere with the enjoyment thereof by the Licensee, and may, to the extent and under the conditions aforesaid, use the Licensee's overhead and underground facilities for supporting or carrying the Licensor's wires (both open and in cable) upon paying a pro rata share of the cost of constructing and maintaining them, computed in accordance with the existing practices of the parties, or such other reasonable compensation as may be agreed upon. The Licensor reserves the right to use telephones on lines passing over the routes or any or either of them of the lines of the Licensee, and connecting, with each other or with said exchanges, places with which the Licensee is not authorized to connect, for the purpose of establishing personal communication or transmitting messages between such places and between such places and said exchanges. The Licensee will also allow the Licensor to connect the wires of any such lines with its said lines in order to constitute thereby a through line, of which the Licensee's lines or any or either of them or any part of either of them can form a portion or link, in order to forward through communications or messages; will make or permit to be made convenient switchboard or other connections for that purpose, and as compensation for such use of its lines and for making such connections will take a share of the through toll (terminal expenses being first deducted) pro rata according to distance, not greater than that customarily charged by it for like distances, and will also allow any telephone exchange located outside the territory of the Licensee to be designated by the Licensor to connect with the Licensee's lines for [fol. 153] the purpose, and substantially in the manner and upon the terms herein provided in respect to such trunk line connections. In respect of all communications or messages originating on its lines and which are to be routed or forwarded over any other lines, the Licensee shall require the patron or subscriber to bind himself to pay the tolls thereon and to make every communication or message subject to such contracts, stipulations, and limitations of liability of such other lines as the Licensor may from time to time require, in such form as it may from time to time prescribe, and will hold the Licensor harmless from all loss or expense consequent upon the Licensee's failure so to do. Whenever the consent of a commission or other public tribunal to the use by the Licensor or the Licensee of the plant or other facilities of the other is required by law, no agreement made under and pursuant to the provisions of this paragraph shall be effective until such consent is obtained.

The Licensor may enter the offices and connect with the ex-

changes of the Licensee any lines to points without the territory of the Licensee or to points within said territory for connection with which the Licensee is not authorized to use telephones furnished hereunder, in order to establish communication between patrons of such exchanges and parties at such points reached by said lines, and may there operate said lines with suitable appliances; the Licensee will permit its patrons to use such lines, and by its own operators will handle such communications or messages to and from its patrons or make the proper switchboard or other connections for direct communication, as may be requested, and in such manner, not inconsistent with the proper conduct of its office, as the Licensor shall direct. But if the Licensor is not satisfied with the manner in which it is performed, it may establish its own offices and trunk and radiating lines for such purpose.

6. The Licensee will cause each of its exchanges to route, over the lines of the Licensor and of such parties as the Licensor may from time to time appoint, all communications to points outside the Licensee's territory, or to points within said territory for connection with which the Licensee is not authorized to use telephones furnished hereunder, originating at such exchanges, on its lines, or at the exchanges or on the lines of its connecting companies within its territory, or coming on the wires or within the control of the exchange, where the Licensor or its said appointee has wires and will accept the same, so far as the Licensee can lawfully control the same and unless otherwise specially directed by its patrons, but the Licensee will not solicit such special directions or receive or pay tolls for transmission over other lines unless compellable by law so to do. Each such communication on which the charge is reversed shall be considered as originating at the station against which the charge is to be made.

The Licensee shall keep and furnish an account of each such communication, and of connections made therefor, and shall collect and on demand pay over to the Licensor or its said appointees, respectively, the tolls for transmission beyond the exchange, according to such rates and rules as each shall establish, and shall exhibit its accounts and the tickets from which they are made, so far as may be proper to verify the same. The Licensee, in the handling of all [fol. 154] business interchanged hereunder shall observe the Licensor's operating methods and rules from time to time established for the use of its lines and shall keep such records and furnish such reports in respect thereto as the Licensor may from time to time request.

Each exchange shall, if and when so requested by the Licensor, make proper switchboard or other connection between the lines of the Licensor or its Licensees from points without such exchange and terminating in such exchange office, for the purpose thereby of making up a through line between points without such exchange. In respect of all the business referred to in this Article, the Licensee shall make no charge to its own subscriber or patron, but shall be entitled to the following compensation and none other: The Licensee

all receive, upon communications originating at an exchange or station of the Licensee or of a connecting company of the Licensee within its territory and passing over the trunk lines reserved to the Licensor by Article 5, fifteen per cent of the amount received from the tolls for each such communication, not to exceed twenty cents for any one communication; provided, however, that whenever the party entitled to said toll employs the toll operator who has charge at or for the originating exchange of completing such communication, the sum to be received by the Licensee for each such communication shall not exceed ten cents, and provided further that the Licensee shall receive upon each such communication originating at a public telephone pay station of an exchange double the aforesaid compensation; the amounts so received as aforesaid by the Licensee to include compensation to the Licensee for the use of all facilities of an exchange furnished for and in connection with such communications whether to or from such exchange, except the facilities required to establish connection between an exchange station and the toll switchboard in which said trunk lines terminate or between an exchange station and the toll trunks when such trunks are employed to effect connection with such toll switchboard; for the use of which excepted facilities the Licensee is compensated by its rates for exchange service in such exchange. In case an exchange shall be required to make a switchboard connection for the purpose of making up a through line between points without such exchange, the exchange shall receive, as compensation for making such connection, such compensation as may be agreed upon.

7. For telephones unlawfully detained from the Licensor or lost or destroyed otherwise than by fire or unavoidable casualty, the Licensee will pay to the Licensor such sum per telephone, not to exceed five dollars, as the Licensor may from time to time determine; but said payments shall not confer any right to the telephone, or to its use, or satisfy any other breach of covenant, or impair the right of the Licensor to obtain possession of any such telephone. The Licensor shall, at its own expense, replace or repair each defective telephone delivered to it for that purpose at the warehouse of the Western Electric Company, Incorporated, most convenient to the territory of the Licensee, and will, as the Licensee may from time to time request, deliver to it at said warehouse such parts for making replacement in telephones in service or on hand as it may then reasonably need; minor parts for such replacements [fol. 155] to be furnished without charge and major parts, as defined from time to time by the Licensor, to be paid for by the Licensee at the reasonable cost thereof, and all such major parts, whether intact, defective or broken, returned by the Licensee to the Licensor at said warehouse to be repurchased by the Licensor at the then current cost to it of corresponding new parts.

8. The Licensee admits the validity of all patents relating to telephony and telephonic appliances now or hereafter held by the Licensor or under which it may hold licenses exclusive in their char-

acter, and the validity of its title thereto, and will not dispute the same.

9. The Licensee is entitled to receive from the Licensor, in addition to all other services and benefits accruing hereunder to the Licensee, the following described services and privileges:

(a) The right to use, subject to the provisions herein set forth, all telephonic devices, apparatus, methods and systems covered by patents now or hereafter owned or controlled by the Licensor or which it may have the right to authorize the Associated Companies of the Bell System to use, and also the right to use, subject to the provisions herein set forth, as and when completed and standardized, all new and improved apparatus and developments in the art of telephony resulting from the research and experimental work conducted by or under the direction of the Licensor and hereinafter referred to; and, without expense to the Licensee, protection and defense against and to be saved harmless from all actions or suits, charging infringement of patents, arising out of the use of telephones furnished hereunder to the Licensee; as well as ample provision for protecting and defending against, and insuring the Licensee against judgments for damages and profits in, all actions or suits, charging infringement of patents, arising out of the use of any apparatus, methods or systems which the Licensor may recommend.

(b) The continuous prosecution by the Licensor of the fundamental work of research, investigation and experimentation in the development of the art and science of telephony and in the development of plans, methods, systems and ideas designed to promote safety, economy and efficiency in the equipment, construction and operation of the telephone plants of the Associated Companies of the Bell System, and the direction by the Licensor of the development work by others for the production of materials and apparatus necessary for rendering the products of such work of the Licensor available for use by such Associated Companies.

(c) Advice and assistance in general engineering, plant, traffic, operating, commercial, accounting (including the auditing of accounts) patent, legal, administrative and other matters pertaining to the efficient, economical and successful conduct of the telephone business of the Licensee; such advice and assistance to be given by the Licensor through the issuance to the Licensee of data, discussions and conclusions, including bulletins, books, circular letters, and standard specifications and blue-prints, and through the performance of specific work in cases of unusual magnitude and complexity where such work is necessary or desirable.

(d) Advice and assistance in any financing required to be done by the Licensee in the extension, development or improvement of [fol. 156] its telephone system within its said territory and in the general matter of its finances; aid in securing funds on fair terms, as and when needed for new construction and other expenditures,

not, at any time, to a greater extent than the then condition of the finances and credit of the Licensor may permit; active assistance in the marketing of the Licensee's securities; and such other necessary financial support and assistance in the premises as will tend to serve the best interests of both Companies.

(e) The right to extend to the subscribers and other patrons of the Licensee and of its connecting companies within its said territory the privilege of using, upon payment of the regular tolls therefor, the connections provided for in said license contracts between the Bell System and the systems of the other Associated Companies of the Bell System for telephonic communication between such subscribers and other patrons and the subscribers and other patrons of such Associated Companies and of their connecting companies in their respective territories.

(f) Active assistance, cooperation and support in connection with the adoption from time to time by the Licensee of such measures as will, in the united judgment of the parties hereto, best protect and preserve the health and promote the well-being in employment of the employees of the Licensee and, in other ways, conserve the high quality of its service to the public through the maintenance of a stable, contented and efficient personnel; the continued maintenance by the Licensor, in accordance with and subject to the terms of the agreement heretofore made by the parties hereto for the interchange of the benefit obligations of the plans heretofore adopted by them respectively and each entitled "Plan for Employees' Pensions, Disability Benefits and Death Benefits," and at not less than its original amount, of the Fund heretofore established by the Licensor under its said Plan; and the continued right to the Licensee, whenever at any time the Fund established under its said Plan shall be insufficient for the performance of its obligations thereunder, to have recourse, to the amount of the deficiency, to said Fund of the Licensor in accordance with and subject to the terms of said agreement for the interchange of benefit obligations.

(g) The right to the Licensee, for the betterment of the service throughout its said territory, to extend to its connecting companies within its said territory, on such terms and conditions as it may determine, the benefit of such engineering and other technical advice and information in respect to construction, maintenance, repair and operation of plant as the Licensee may receive from the Licensor.

10. In order that the foregoing services may be promptly and efficiently performed when needed by the Licensee, the Licensor will:

(a) Render available for use by the Associated Companies of the Bell System all products of the Licensor's fundamental work of research, investigation and experimentation, and all inventions, discoveries and patents, and all methods and systems covered by patents, relating to the art of telephony, or all apparatus and appliances, methods and systems embodying such inventions, discoveries and

patents, which, after investigation, experimentation and tests, are [fol. 157] in each case pronounced by the technical experts of the Licensor to be of advantageous and practical usefulness in telephone and recommended for use, and to this end, if any patent rights held by others in any such invention or discovery are necessary to make such invention or discovery available for such use, the Licensee will, in case such invention or discovery relates to telephones, acquire the requisite patent rights therein, and, in case such invention or discovery relates to other than telephones, provide suitable arrangements for making the apparatus, appliances, methods and systems embodying such invention or discovery available for use as aforesaid, provided that each such acquisition or arrangement can, in the judgment of the Licensor, be consummated on reasonable terms.

(b) Maintain continuously an organization of specialists trained in the various branches of the work required to be done by the Licensor in rendering the foregoing services, of such numbers and possessed of such technical knowledge and experience as will enable said work to be so done as to relieve the Licensee from the necessity of attempting to perform said work for itself.

(c) Maintain continuously or cause to be so maintained proper circuit and other facilities for connections, as herein provided, between the said system of the Licensee and the systems of the other Associated Companies of the Bell System for telephonic communication between the subscribers and other patrons of the Licensee and of its connecting companies within its said territory and the subscribers and other patrons of such other Associated Companies and of their connecting companies within their respective territories.

11. In consideration for said license contracts and for all benefits accruing to the Licensee hereunder, the Licensee is paying and shall continue to pay to the Licensor a sum equal to four and one-half per cent. (4½%) of the total gross earnings of the Licensee, which shall be payable in monthly installments, as herein provided, and in accordance with the established practice of the parties hereto, and shall be computed as follows: Such total gross earnings shall comprise the following accounts described and defined in the Licensor's Accounting Circular No. 8, Standard Telephone Accounts, Bell Telephone System, issued under date of December 28, 1912: Account 500 Subscribers' Station Revenues, Account 501 Public Pay Station Revenues, Account 504 Private Exchange Lines, and Account 510 Message Tolls. From the total of such accounts, shall be deducted Account 304 Uncollectible Operating Revenues. To the difference between the aforesaid revenues and the aforesaid deductions therefrom shall be added (a) the sum of Seventy-five Cents (75¢) per telephone per month for all telephones not in use in excess of three per cent. (3%) of the total number of telephones standing charged to the Licensee on the last day of such month, said three per cent. (3%) representing the maximum number of telephones believed to be necessary to be kept in stock by the licensee, and (b) for sub-licensed or other operating telephone companies not under license

contracts from the Licensor and in which the Licensee owns a majority of the capital stock, the same proportion of their gross revenues computed as aforesaid as the proportion of their stock [col. 158] which is owned by the Licensee; provided, however, that, on application by the Licensee for the exclusion of such gross revenues of any such sublicensed or operating company, the question shall be carefully considered and determined on the facts in each such case.

The amount of each installment of said sum equal to four and one-half per cent ($4\frac{1}{2}\%$) of the Licensee's total gross earnings for each month shall be determined by such total gross earnings of the second preceding month, computed in the manner aforesaid, and a statement, over the signature of the proper accounting officer of the Licensee, of its total gross earnings for each calendar month, computed in the manner aforesaid, with the number of telephones in use and in stock in its territory on the fifteenth day of said calendar month shall be sent to the treasurer of the Licensor, or to such other officer of the Licensor as it may theretofore designate, on or before the twenty-fifth day of the next succeeding month and payment in Boston or New York funds shall be made on or before the tenth day of the month next following, that being the month for which such payment is due. Further statements of telephones shall be made by the Licensee at such times and in such detail as the Licensor may from time to time request.

The Licensee will make such reports, giving such information regarding the operations of its exchanges and lines as the Licensor may from time to time request.

12. If the Licensee shall fail to pay any sums due hereunder or thirty days after the same shall become payable, or shall violate any other terms or conditions of this memorandum, and shall persist in such default, violation, or neglect or fail to remedy or repair the same for sixty days after written notice thereof from the Licensor, or shall become bankrupt or insolvent, the Licensor may, if it shall so elect, by written notice to the Licensee, terminate all rights of the Licensee hereunder, and may resort to any of its rights and remedies in law or in equity, under the patent laws or otherwise, including the remedy by injunction against the Licensee or those claiming under it, for the use of any of its patented inventions or telephones not justified by a subsisting license hereunder, or for the violation of any other of its rights. The Licensor may also upon such termination, if it so elects, take possession of all lines, switchboards, fixtures, apparatus, appliances, and premises of the Licensee used for carrying on its business, and occupy and operate the same, or connect such lines with offices of its own; and collect from any patron, subscriber or other party all sums then or thereafter due to the Licensor or to the Licensee for the use of any telephones, circuits and appliances, or under any subscription contract or under any sub-license or connecting agreement for the interchange of business; and may enforce these provisions by an entry, without being deemed guilty of any trespass, or by legal process,

including an injunction to prevent any interference with the Licensors (and others permitted by it) in the use of said telephones, lines, switchboards, fixtures, apparatus and appliances. The property so taken, which does not belong to the Licensors or revert to it hereunder, may be returned within three months from the taking, in which case it shall pay to the Licensee a reasonable compensation [fol. 159] for its use, or the Licensors may retain the same as its own property and shall pay therefor a reasonable price (not exceeding the actual cost) within four months after the taking, and shall account to the Licensee for all sums collected which accrued before the Licensors became so entitled to possession, deducting all expenses incident thereto, and all that may be due to it. These rights and remedies of the Licensors shall, in case of any default, if the Licensors shall so elect, apply only to the exchange or exchanges in which such default has occurred. The Licensors may also use the name of the Licensee to protect the Licensors' interests and to enforce the Licensors' rights hereunder, and the Licensee shall execute assignments in accordance herewith.

13. The contractual relations hereunder are personal to the Licensee, and any assignment or attempt to assign its rights hereunder or the lines established hereunder or any or either of them by act of the party or operation of law, without the written consent of the Licensors, will be good ground for a cancellation hereof by the Licensors. The Licensee will keep and observe all the stipulations herein contained on its part to be kept and performed. Whenever the Licensors grants to others the rights for exchanges or any of its rights under Articles 5 and 6 hereof or for connecting lines or any other rights remaining to it, the stipulations hereof relating thereto shall be binding upon and inure to the benefit of such grantees, and the Licensors shall not be responsible for their acts or defaults. If the Licensors shall transfer to any party who shall agree to perform the stipulations hereof, its title to the telephones furnished and licensed hereunder and the patent rights under which they are licensed, and its then existing rights hereunder, the provisions hereof shall inure to the benefit of and be binding upon such party in respect of all things done or to be done after such assignment, as if it were named a party hereto, and the Licensors shall no longer be responsible hereunder.

14. The Licensee shall assume and pay any and all taxes, whether federal, state, county, municipal or other, which may be assessed for or on account of or by reason of the telephones furnished or business done hereunder, to whomsoever assessed.

15. The rights of the Licensee hereunder shall be perpetual, unless sooner determined as herein provided, and the territory hereinabove referred to as the territory of the Licensee is as follows, viz.:

The State of New York; the Counties of Bergen, Essex, Hudson, Middlesex, Monmouth, Morris, Passaic, Somerset, Sussex and Union, all in the State of New Jersey; and such part of the State of Connecticut as is comprehended within a radius of thirty-three

(33) miles from the New York City Hall, subject, however, to the rights of The Southern New England Telephone Company under its agreement with the Licensee, dated August 5, 1905, in respect to that portion of Fairfield County, in the State of Connecticut, east of the Mianus River and west of said thirty-three (33) mile limit in and around sections known as Riverside and Sound Beach, as shown approximately in the diagram attached to said agreement and marked "Exhibit A"; except that the Licensee shall have no right (except as heretofore authorized by the Licensor in specific [fol. 160] cases) to use telephones furnished hereunder, except in connection with the trunk lines reserved to the Licensor under the provisions of article 5 hereof, for the purpose of communication between the following points, to wit:

1. Between any point in the Counties of Bronx, Kings, Nassau, New York, Putnam, Queens, Richmond, Rockland, Suffolk and Westchester, and such portion of Orange County as is comprehended within a radius of thirty-three (33) miles from the New York City Hall, and the Town of Tuxedo in said County of Orange, all in the State of New York, and the Counties of Bergen, Essex, Hudson, Middlesex, Monmouth, Morris, Passaic, Somerset, Sussex and Union, all in the State of New Jersey, and such portion of the State of Connecticut as lies within a radius of thirty-three (33) miles from the New York City Hall, and any other point in the territory of the Licensee covered by this memorandum;

2. Between any point in the Counties of Albany, Clinton, Columbia, Dutchess, Essex, Franklin, Fulton, Greene, Montgomery, Orange, except such portion of Orange County as is comprehended within a radius of thirty-three (33) miles from the New York City Hall and except the Town of Tuxedo in said Orange County, Rensselaer, Saratoga, Schenectady, Schoharie, Sullivan, Ulster, Warren and Washington, all in the State of New York, and any other point in the territory of the Licensee covered by this memorandum;

3. Between any point in the Counties of Chenango, Delaware, Hamilton, Herkimer, Jefferson, Lewis, Madison, Oneida, Onondaga, Otsego and St. Lawrence, all in the State of New York, and any other point in the territory of the Licensee covered by this memorandum;

4. Between any point in the Counties of Allegany, Broome, Cattaraugus, Chautauqua, Chemung, Schuyler, Steuben, Tioga and Tompkins, all in the State of New York, and any other point in the territory of the Licensee covered by this memorandum;

5. Between any point in the Counties of Cayuga, Cortland, Ontario, Oswego, Seneca, Wayne and Yates, all in the State of New York, and any other point in the territory of the Licensee covered by this memorandum, and

6. Between any point in the Counties of Erie, Genesee, Livingston, Monroe, Niagara, Orleans and Wyoming, all in the State of New

York, and any other point in the territory of the Licensee covered by this memorandum.

16. This memorandum shall not be so construed or so made to apply as to affect any exclusive rights reserved to the Licensee by the certain agreement dated September 30, 1909, between the Licensor, the Licensee, and The Bell Telephone Company of Buffalo, being certain rights referred to in a certain license contract dated June 1, 1880, between The American Bell Telephone Company and the Metropolitan Telephone and Telegraph Company, predecessor in business of the Licensee.

17. Said license contracts, as now and heretofore in effect and as evidenced by this Memorandum, are hereby in all respects ratified and confirmed.

In witness whereof, the parties hereto have caused their respective [fols. 161 & 162] five corporate seals to be hereto affixed and these presents to be subscribed in their names and behalf by their respective officers thereto duly authorized.

American Telephone and Telegraph Company, by H. B. Thayer, President. Attest: A. A. Marsters, Secretary (Seal.) O. K. N. T. G. New York Telephone Company, by H. F. Thurber, President. (Seal.) Attest: W. Hoppins, Secretary. Approved as to form. J. L. Swayze, General Counsel, June 5, 1920.

[fol. 163]

[File endorsement omitted]

[fol. 164]

IN UNITED STATES DISTRICT COURT

[Title omitted]

AFFIDAVIT OF JAMES T. MORAN—Filed Feb. 5, 1925

STATE OF CONNECTICUT,

County of New Haven, ss:

James T. Moran, being duly sworn, deposes and says:

I reside in New Haven, Connecticut, and am President & General Attorney of the Southern New England Telephone Company, which operates a telephone system throughout the State of Connecticut. I have been connected with said Company since 1884 as Attorney, General Attorney, Vice President, General Manager, and President. In February, 1917, I was elected President & General Attorney, which offices I have occupied since that date.

The outstanding capital stock of the Southern New England Telephone Company is \$21,000,000 divided into 210,000 shares of the par value of \$100 each. The American Telephone and Telegraph Company owns 70,020 shares or 33.34% of the total outstanding

capital stock and the balance of 63.66% of the total, consisting of 139,980 shares is owned by independent stockholders. The Southern New England Telephone Company has a Board of Directors and an Executive Committee which is selected from its Board of Directors. The Board of Directors is elected annually by the stockholders and controls and directs the affairs of the Company and elects its officers. There are eleven members of the Board of Directors and six members of the Executive Committee. The American Telephone and Telegraph Company is represented on the Board of Directors by two members and on the Executive Committee by one. It has never had more than two members upon the Board of Directors nor more than one member upon the Executive Committee. The Directors representing the American Telephone and Telegraph Company have generally not attended the meetings of the Board of Directors or the Executive Committee unless specially requested to do so by the management of the Southern New England Telephone Company. At no meeting of the stockholders of the Southern New England Telephone Company has the stock owned by the American Telephone and Telegraph Company constituted a majority of the stock represented at the meeting.

The Southern New England Telephone Company has a contract with the American Telephone and Telegraph Company which is generally referred to as the "License Contract." I have read the [fol. 165] affidavit of Mr. Tage P. Sylvan, Vice President of the New York Telephone Company, verified January 29, 1925, and submitted by plaintiff in this suit. The license contract of the Southern New England Telephone Company is substantially similar to the contract attached as an exhibit to said affidavit and marked "Exhibit T. P. S.—No. 1." The services set forth in said affidavit are of the same character as those rendered to the Southern New England Telephone Company under its license contract and compensation for said services is made upon the same basis. The relationship established by this contract between these companies was first entered into May 1, 1884, and has been continuous since that time and is now evidenced by a contract dated November 14, 1918, entitled "Agreement between American Telephone and Telegraph Company and the Southern New England Telephone Company covering telephones, services, licenses and privileges."

When the original agreement was consummated in 1884 the Southern New England Telephone Company was entirely independent of the American Bell Telephone Company, the predecessor of the American Telephone and Telegraph Company. Said Southern New England Telephone Company has continued entirely independent of said American Bell Telephone Company and its successor, the American Telephone and Telegraph Company, since that time. When the original agreement was consummated said American Bell Telephone Company owned only forty-three (43) shares of stock of said Southern New England Telephone Company out of a total issue outstanding at that time of 9038 shares.

I am familiar, generally, with the services furnished by the American Telephone and Telegraph Company to the several

associated operating companies in consideration of the payment made under the existing license agreements. It is my understanding that all said companies, including the New York Telephone Company, the plaintiff in this suit, receive services of the same character as those rendered to the Southern New England Telephone Company.

Certain services rendered under this contract, which can be evaluated with substantial accuracy, show large savings in annual charges to the Southern New England Telephone Company amounting to many times the payment made under the contract but to my mind there are many things secured through this contract which are of the greatest value and which cannot be evaluated in dollars.

In the first place, there is universal service, which would not be possible without some relationship which resulted in a single system with standardized apparatus, equipment and operating methods and which is of tremendous benefit to every telephone company in the United States.

In the second place, there is the assurance that the Southern New England Telephone Company and other companies which have the benefit of the license agreement will have available for use and for the use of subscribers whatever there is new in the art, which from time to time is demonstrated to be valuable in bringing about efficient and economical telephone service.

In my judgment as an officer and executive of the Southern New England Telephone Company and an experienced telephone man, the services furnished by the American Telephone and Telegraph [fol. 166] Company are worth to the associated companies more than the amounts paid for such services. The Southern New England Telephone Company continues this contract because the arrangement is of very substantial value to it. There is no other source from which similar services could be procured and services of the same character could not be performed by the Southern New England Telephone Company itself. If my Company did not have the contract I would, as an officer and executive, be in favor of negotiating such a contract with the American Telephone and Telegraph Company, if it were possible to do so.

I concur in all respects in the opinions expressed by Mr. Tage P. Sylvan as to the value of this relationship as set forth in the affidavit above referred to.

(Sd.) James T. Moran.

Subscribed and sworn to before me this 2nd day of February, 1925. (Sd.) Clinton J. Benjamin, Notary Public, State of Connecticut, City and County of New Haven. My Commission expires Feby. 1st, 1929. (Seal.)

[fol. 167]

IN UNITED STATES DISTRICT COURT

[Title omitted]

AFFIDAVIT OF BENJAMIN T. MCBURNEY—Filed Feb. 5, 1925

STATE OF OHIO,

County of Hamilton, ss:

Benjamin T. McBurney, being duly sworn, deposes and says:

I reside at Cincinnati, Ohio, and have been for more than four years continuously last past, Vice President & Assistant General Manager of the Cincinnati & Suburban Bell Telephone Company, a company which operates a telephone system in Cincinnati, Ohio, and adjacent territory. I have been engaged in the telephone business for more than twelve years.

The American Telephone and Telegraph Company owns 30% of the common stock of the Cincinnati & Suburban Bell Telephone Company and said American Telephone and Telegraph Company has never at any time owned the controlling interest, directly or indirectly, in said Cincinnati & Suburban Bell Telephone Company and does not control the policy of said Company in the making of contracts or otherwise.

Said Cincinnati & Suburban Bell Telephone Company has, upwards of forty years last past, had a contract with the American Telephone and Telegraph Company and its predecessor, the American Bell Telephone Company, which is generally known as the "License Contract".

I have read the affidavit of Mr. Tage P. Sylvan, Vice President of the New York Telephone Company, the plaintiff herein, which said affidavit was verified January 29, 1925 and was submitted by plaintiff in this suit. The services as set forth in said affidavit as rendered by said American Telephone and Telegraph Company to said New York Telephone Company are of the same character as those rendered by said American Telephone and Telegraph Company to my Company under said license contract and for which said services my Company pays at the same rate, viz. 4½% of its gross receipts. In my opinion the Cincinnati & Suburban Bell Telephone Company could not successfully operate its business without the services which it receives under said license contract and there is no other source from which such services could be procured. It is my opinion further that the services so rendered are worth more than the amount paid by my Company therefor and that it would be [fols. 168-170] impossible for my Company to perform for itself services of the same character and of the same value as the services procured under said license contract. It is my further opinion that the method of payment, based upon a percentage of the gross revenues, is fair, just and equitable.

I concur fully in all of the opinions expressed by Mr. Tage P. Sylvan in his affidavit above referred to as to the value of the serv-

ices furnished by the American Telephone and Telegraph Company to the associated companies under the license contract.

(Sd.) Benjamin T. McBurney

Subscribed and sworn to before me this 2nd. day of February, 1925. (Sd.) Werter G. Betty, Notary Public, Hamilton Co., Ohio. My Commission expires August 23, 1925. (Seal.)

[fol. 171]

[File endorsement omitted]

[fols. 172-174] IN UNITED STATES DISTRICT COURT

[Title omitted]

ANSWER OF DEFENDANTS, HARRY V. OSBORNE, JOSEPH F. AUTENRIETH, AND FREDERICK W. GNICHTEL—Filed March 16, 1925

The Answer of the Defendants, Harry V. Osborne, Joseph F. Autenrieth, and Frederick W. Gnichtel, Constituting the Board of Public Utility Commissioners of the State of New Jersey.

These defendants, answering the bill of complaint for said defendants say:

1. These defendants hereby adopt as their answer to the bill filed in this cause the answer made and filed for and on behalf of the defendant Board of Public Utility Commissioners.

Thomas Brown, Solicitor for and of Counsel with the Defendants, Harry V. Osborne, Joseph F. Autenrieth, and Frederick W. Gnichtel, constituting the Board of Public Utility Commissioners of the State of New Jersey.

[fol. 175]

[File endorsement omitted]

[fol. 176]

IN UNITED STATES DISTRICT COURT

[Title omitted]

ANSWER OF DEFENDANT COMMISSION—Filed March 13, 1925

The answer of the defendant, Board of Public Utility Commissioners, a board created by an act entitled, "An act concerning public utilities, to create a Board of Public Utility Commissioners, and to prescribe its duties and powers," chapter 195 of the Public Laws of the State of New Jersey, 1911, and the amendments thereto and supplements thereof, to the bill of complaint of the plaintiff, New York Telephone Company.

This defendant, Board of Public Utility Commissioners, answering the bill of complaint for said defendant says:

I. The defendant admits the incorporation of the plaintiff and its operation and ownership of a telephone system in the counties mentioned, for telephone exchange service and both intrastate and interstate telephone service.

The defendant denies that telephone service as rendered by the plaintiff and its property in the State of New Jersey is limited to telephone exchange service and the intrastate telephone toll service between points in said state; and further answering says the telephone service rendered by the plaintiff and its property in the State of New Jersey consists of:

(1) Exchange service between telephone stations located within the same local service area;

(2) Toll service between telephone stations in different local service areas, completed over toll lines (without using long distance lines of the American Telephone & Telegraph Company), both interstate and intrastate;

(3) Long distance service between telephone stations in different local service areas, using the long distance lines of the American Telephone & Telegraph Company, both interstate and intrastate;

(4) Private line service both interstate and intrastate.

(5) Service rendered by the plaintiff to the American Telephone & Telegraph Company through the leasing of the properties of the plaintiff located in the State of New Jersey, owned and maintained by the plaintiff for telephone service and leased wire, telegraph, radio, the transmission of pictures and other services;

(6) Property owned and maintained by the plaintiff within the State of New Jersey which is leased by the plaintiff to railroad companies; together with other services.

[fol. 177] II. The defendant admits the persons referred to in paragraph (II) of the bill constitute the defendant Board and says that it has the powers and duties, both administrative and otherwise, conferred by said act and its supplements and amendments, for the supervision and regulation of, jurisdiction and control over all public utilities, their property, property rights, equipment, facilities and franchises as far as may be necessary to carry out the purposes of said act and including the authority to fix just and reasonable rates, charges and schedules which shall be imposed, observed and followed by the plaintiff in rendering service to its customers, in the State of New Jersey. Except as herein admitted, the defendant denies the allegations of paragraph (II).

III. The defendant admits that the suit brought by the plaintiff against it is in the nature of a civil action and says that the proposed rates for telephone service within the State of New Jersey filed by the plaintiff on March 6, 1924, were and are unjust and unreasonable for the reasons stated in the decision and order constituting part of Exhibit "A" annexed to the bill and particularly because the plaintiff did not sustain the burden imposed upon it by Chapter 195 of Public Laws of the State of New Jersey, 1911, the amendments thereto and supplements thereof; to satisfy the defendant that the

proposed increase, change and alteration in the existing rates, charges and schedules filed by the plaintiff with the defendant were just and reasonable. The defendant denies it ordered that the rates for telephone service now, or then charged, be continued in force from and after January 1, 1925. It admits it ordered the plaintiff to keep certain of its accounts, relating to the reserves for depreciation and the amortization of intangible capital, and make certain prescribed entries therein, as required by its decision and order.

The defendant denies that it made any order such as referred to in the "First" reason under paragraph (III) of the bill, and further denies that any order made by it deprives the plaintiff of its property without due process of law or in any manner whatsoever violates the plaintiff's rights under the Fourteenth Amendment to the Constitution of the United States or violates in any respect the legal or constitutional rights of the plaintiff. The defendant denies that the rates fixed and prescribed in its order for the charges to Depreciation Expense and to Amortization of Landed Capital and Clearing Accounts (concurrent credits to be made to the corresponding reserve accounts), are inadequate and that compliance with said order, in this respect, would deprive plaintiff of its property without due process of law or deny the plaintiff the equal protection of the law or in any manner whatsoever violate the plaintiff's rights under the Fourteenth Amendment to the Constitution of the United States. The defendant denies that it "theoretically" required the plaintiff to increase its current net earnings so as to show in the accounts referred to in item "Third" in paragraph (III) of the bill, but did order the plaintiff to make charges to expenses for depreciation and for amortization that are reasonable for depreciation and capital amortization, as found from the testimony adduced before the defendant.

[fol. 178] The defendant denies that the rates per cent. fixed and prescribed in said order for the charges to Depreciation Expense and to Amortization of Landed Capital, and Clearing Accounts (concurrent credits to be made to the corresponding reserve accounts), are inadequate or that compliance with said order will deprive the plaintiff of its property without due process of law or in violation of its Constitutional rights. The order complained of was made by this defendant under the authority of Chapter 195 of the Public Laws of the State of New Jersey, 1911, and the amendments thereto and supplements thereof, wherein the plaintiff is required to make adequate provision for the depreciation of its property in the State of New Jersey and make or cause to be made proper entries upon its books therefor.

This defendant alleges that the depreciation rates provided for in the decision and order of the defendant are those rates which the defendant has found in the proceeding before it, after a thorough, exhaustive and scientific investigation by engineers and expert witnesses, of the actual history and experience of the plaintiff's property in the State of New Jersey, to be reasonable and necessary.

The defendant alleges that the depreciation rates set forth in its decision and order will provide (during the lives of the different

classes of property) amounts which, together with the net salvage to be realized when the property is retired, will equal the cost of the property when installed.

This defendant alleges that the plaintiff, in providing in the past for depreciation, has underestimated both the average life and the salvage, and this has resulted in the accumulation of a depreciation reserve, up to the date of the decision and order referred to in the bill, which is excessive to the extent of at least \$5,300,000.

The depreciation rates claimed by the plaintiff in its bill, if continued to the end of the life of its property in service, would equal amounts, which when added to the depreciation reserve, not only 100 per cent. of book cost (which is the original cost to the plaintiff) of said property but substantially \$15,000,000 in excess thereof.

This defendant further answering says, that the decision and order complained of will not reduce the depreciation reserve already accumulated by the plaintiff but will prevent the plaintiff from increasing unduly its depreciation reserve, which is already excessive, until the true depreciation requirements of the property have equalled the depreciation reserves already accumulated.

The defendant admits the amount involved in this suit exceeds the sum of \$3,000.

Except as herein admitted, the defendant denies the allegations of paragraph (III) of the bill.

IV. The defendant denies that it prescribed or ordered to be effective from and after January 1, 1925, any schedule of telephone rates and particularly the schedule referred to in paragraph (IV) of the bill. It denies that the rates for telephone exchange service now in effect have been in effect for upward of ten years as alleged in said paragraph. On or about September 1, 1918, the Postmaster [fol. 179] General of the United States, then and there having supervision and control of the plaintiff's property and its service in the State of New Jersey, promulgated and established for said plaintiff a substantial increase in charges for all of the service rendered by said company, which increases produced a substantial and very profitable return to the plaintiff. In the year 1920, this defendant, after notice upon hearing on a petition filed by the New York Telephone Company and after considering the evidence adduced before it, determined that the charges for service rendered by the plaintiff in the State of New Jersey and the returns therefor, at that time in effect, should continue and were just and reasonable rates, which rates allowed a reasonable rate of return upon the fair value of the plaintiff's property used and useful and reasonably necessary to afford service to the public. The plaintiff did not at the hearing in the year 1920, or at the hearing before this defendant resulting in the decision and order entitled Exhibit "A" annexed to the bill, offer any evidence as to the segregation of its intrastate and interstate telephone property, revenues or expenses in the State of New Jersey nor any evidence on the basis of which such segregation could be made. The rates charged by the plaintiff for its intrastate and interstate toll service are the rates that have been fixed and charged by the plain-

tiff of its own volition and by the United States Government through the Postmaster General insofar as this defendant is informed or has sufficient knowledge to form a belief. Except as herein admitted the defendant denies the allegations of paragraph (IV) of the bill.

V. The defendant admits on or about March 6, 1924, the plaintiff filed with defendant a schedule of exchange rates providing for increases generally throughout the territory of New Jersey and the said plaintiff proposed that said rates should become effective April 1, 1924, but this defendant says that said proposed rates were unjust and unreasonable and at the hearings held before this defendant the plaintiff failed to sustain the burden of proof, as required by Chapter 195 of the Public Laws of the State of New Jersey, 1911, and the amendments thereto and supplements thereof, that the rates proposed by the plaintiff were just and reasonable. The plaintiff did not introduce at said hearing or at any time any testimony upon which could be based or found a rate to be charged for toll service by the plaintiff in the State of New Jersey as distinguished from the exchange service, nor was any reference made to such segregation in the schedule filed by the plaintiff with this defendant on March 6, 1924. At the hearing held before this defendant resulting in the decision and order contained in the exhibit annexed to the bill, the plaintiff expressly stated that the plaintiff had not attempted to segregate as between interstate and intrastate property and that all of the plaintiff's exhibits show a total property and total revenue and expense from all operations in New Jersey, including both interstate and intrastate service.

The defendant admits that by an order dated March 11, 1924, and again by an order dated June 30, 1924, it suspended the proposed rates filed by the plaintiff with the defendant as alleged in paragraph (V) of the bill. That because of the delay in offering [fol. 180] proof in the investigation and hearing of said rate case and by reason of the inability of plaintiff and defendant's witnesses to give testimony and furnish exhibits within the suspended period last aforesaid, by and with the consent of the plaintiff, the order of suspension was continued until January 1, 1925. The defendant admits the decision and order made by it and annexed as Exhibit "A" to the bill wherein the defendant determined that the plaintiff failed to sustain the burden imposed upon it by law to satisfy the defendant that the proposed increase, change or alteration in the plaintiff's existing rates, charges and schedules were just and reasonable. The defendant denies that it prescribed by order that the rates then existing and in effect should be kept in force on and after the effective date, December 31, 1924. Except as herein admitted the defendant denies the allegations of paragraph (V) of the bill.

VI. This defendant denies the allegations contained in paragraph (VI) of the bill that the fair and reasonable value of the property of the plaintiff in the State of New Jersey at the date of said order and now being used and useful and reasonably necessary in furnishing intrastate telephone service is \$74,600,000. The defendant further answering says that less than 10 per cent of plaintiff's prop-

erty in the State of New Jersey is "exclusively devoted" to the rendition of either intrastate or interstate telephone service and that over 90 per cent of the plaintiff's property in the State of New Jersey is used indiscriminately for both intrastate and interstate service. The fair and reasonable value of the entire property of the plaintiff in the State of New Jersey used and useful and reasonably necessary for all classes of service furnished by plaintiff on December 31, 1924, did not exceed the sum of \$82,600,000. This defendant denies that the cost of reproduction of the property of the plaintiff in the State of New Jersey used and useful in furnishing its intrastate telephone service and "exclusively devoted to the rendition of that service" was \$84,400,000; and further answering says that the cost of reproduction of the entire property of the plaintiff in the State of New Jersey used and useful and reasonably necessary in rendering the service furnished by plaintiff does not exceed \$94,000,000.

The defendant denies that the cost of property of the plaintiff at the date of said decision and order and now being used and useful in furnishing its intrastate telephone service to the public and exclusively devoted to the rendition of that service is \$34,452,242 and says that the cost to the plaintiff of its entire property in the State of New Jersey used and useful and reasonably necessary in rendering the service furnished by plaintiff does not exceed \$80,100,000.

This defendant says that the cost to the plaintiff of its property should not include anything on account of the item of franchises or the item known as "Going Value" for the reason that such costs, if any, have been paid for through the operating expenses and should not also be included in the capital account of the plaintiff.

The defendant denies that the cost of reproduction and the fair and reasonable value of the plaintiff's property "devoted exclusively" to its intrastate telephone service should include an item of \$9,034,438 [fol. 181] for "Going Value." This defendant found from the evidence offered at the hearings before this defendant that the reasonable value of this item of the plaintiff's entire property in the State of New Jersey devoted to all of its service did not reasonably exceed the sum of \$3,600,000.

And this defendant further answering says that the estimates of cost and value of the plaintiff's property, referred to in paragraph (VI) of the bill and alleged to be "exclusively devoted" to its intrastate telephone service, include the cost and value of property devoted to intrastate toll service and to all other intrastate services furnished by plaintiff in addition to the exchange service, the rates for which were disallowed in the decision and order complained of. The value of the property devoted to those other services amounts to several millions of dollars, the exact amount of which is without the knowledge of this defendant.

VII. The defendant denies the allegations contained in paragraph (VII) of the bill and says that the net earnings from telephone exchange service under the schedule of rates filed by the plaintiff with the defendant, together with the net earnings from rates for all other services comprising the plaintiff's entire business in the State of New

Jersey, using depreciation rates found by the defendant stated rate per cent annual return upon the fair and reasonable value of the entire property of the plaintiff used and useful and reasonably necessary in rendering service by the plaintiff during the following periods would be at least:

For the year 1922, 10.05%.

For the year 1923, 9.70%.

For the year 1924, 8.22%.

Defendant says that the net earnings derived by the plaintiff from its entire telephone business within the State of New Jersey under the rates for telephone exchange service now in effect, together with the net earnings from rates for other service, stated in the rate per cent annual return upon the fair and reasonable value of the entire property of the plaintiff used and useful and reasonably necessary in furnishing said service, if the order of the defendant had been made effective in 1922, would have yielded more than 7.5 per cent; and if made effective in 1923, would have yielded more than 7.5 per cent; and if made in 1924, would have yielded more than 7.5 per cent; and if made effective in 1925, will yield more than 7.5 per cent for at least two years.

And this defendant further answering says that the estimates of cost and value of the plaintiff's property, referred to in paragraph (VII) of the bill and alleged to be "exclusively devoted" to intrastate telephone service, include the cost and value of property devoted in intrastate toll service and to all other intrastate services furnished by plaintiff in addition to the exchange service, the rates for which exchange service alone were disallowed in the decision and order complained of. The value of the property devoted to other than exchange services amounts to several millions of dollars, the exact amount of which is without the knowledge of this defendant.

VIII. The defendant denies the allegations contained in paragraph (VIII) of the bill and says that the net earnings from telephone exchange service under the schedule of rates filed by the [fol. 182] plaintiff with the defendant, together with the net earnings from rates for all other services comprising the plaintiff's entire business in the State of New Jersey, using depreciation rates found by the defendant dated in rate per cent annual return upon the value of the entire property of the plaintiff used and useful and reasonably necessary in rendering service by the plaintiff during the following periods would be at least:

For the year 1922, 10.44%.

For the year 1923, 10.03%.

For the year 1924, 8.51%.

Defendant says that the net earnings derived by the plaintiff from its entire telephone business within the State of New Jersey under the rates for telephone exchange service now in effect, and

gether with the net earnings from rates for other service, stated in the rate per cent. annual return upon the cost of the entire property of the plaintiff used and useful and reasonably necessary in furnishing said service, if the order of the defendant had been made effective in 1922, would have yielded more than 7.7 per cent.; and if made effective in 1923, would have yielded more than 7.7 per cent.; and if made effective in 1924, would have yielded more than 7.7 per cent.; and if made effective in 1925, will yield more than 7.7 per cent. for at least two years.

And this defendant further answering says, that the estimates of cost and value of the plaintiff's property, referred to in paragraph (VIII) of the bill and alleged to be "exclusively devoted" to its intrastate telephone service, include the cost and value of property devoted to intrastate toll service and to all other intrastate services furnished by plaintiff in addition to the exchange service, the rates for which exchange service alone were disallowed in the decision and order complained of. The value of the property devoted to other than exchange services amounts to several millions of dollars, the exact amount of which is without the knowledge of this defendant.

Except as herein admitted the defendant denies the allegations of paragraph (VIII) of the bill.

IX. This defendant denies the allegations contained in paragraph (IX) of the bill that the fair and reasonable value of the property of the plaintiff in the State of New Jersey at the date of said decision and order and now being used and useful and reasonably necessary in furnishing telephone service, both intrastate and interstate, is \$97,286,319. The defendant further answering says that the fair and reasonable value of the entire property of the plaintiff in the State of New Jersey used and useful and reasonably necessary for all classes of service furnished by plaintiff on December 31st, 1924, did not exceed the sum of \$82,500,000.

This defendant denies that the cost of reproduction of the property of the plaintiff in the State of New Jersey used and useful in furnishing its telephone service and "exclusively devoted to the rendition of that service" was \$110,303,367 and says that the cost of reproduction of the entire property of the plaintiff in the State of New Jersey used and useful and reasonably necessary in rendering the service furnished by plaintiff does not exceed \$94,000,000. [fol. 183] The defendant denies that the cost of property of the plaintiff at the date of said decision and order and now being used and useful in furnishing its telephone service to the public and exclusively devoted to the rendition of that service" is \$82,899,597, and says that the cost to the plaintiff of its entire property in the State of New Jersey used and useful and reasonably necessary in rendering the service furnished by plaintiff does not exceed \$80,000,000.

This defendant says that the cost to the plaintiff of its property should not include anything on account of the item of franchises of the item known as "Going Value"; that such costs have been

paid for through the operating expenses and should not also be included in the capital account of the plaintiff.

The defendant denies that the cost of reproduction and the fair and reasonable value of the plaintiff's property "exclusively devoted" to its telephone service should include an item of \$117,500 for "Going Value." This defendant found from the evidence offered at the hearings before it that the reasonable value of this item of the plaintiff's entire property in the State of New Jersey devoted to all of its service did not exceed the sum of \$3,600,000.

X. The defendant denies the allegations contained in paragraph (X) of the bill and says that the net earnings from telephone exchange service under the schedule of rates filed by the plaintiff with the defendant, together with the net earnings from rates for all other services comprising the plaintiff's entire business in the State of New Jersey, using depreciation rates found by the defendant, stated in rate per cent. annual return upon the fair and reasonable value of the entire property of the plaintiff used and useful and reasonably necessary in rendering service by the plaintiff during the following periods would be at least:

For the year 1922, 10.05%

For the year 1923, 9.70%

For the year 1924, 8.22%

Defendant says that the net earnings derived by the plaintiff from its entire telephone business within the State of New Jersey under the rates for telephone exchange service now in effect together with the net earnings from rates for other service, stated in the rate per cent. annual return upon the fair and reasonable value of the entire property of the plaintiff used and useful and reasonably necessary in furnishing said service, if the order of the defendant had been made effective in 1922, would have yielded more than 7.5 per cent.; and if made effective in 1923, would have yielded more than 7.5 per cent.; and if made effective in 1924, would have yielded more than 7.5 per cent.; and if made effective in 1925, will yield more than 7.5 per cent. for at least two years.

XI. The defendant denies the allegations contained in paragraph (XI) of the bill and says that the net earnings from telephone exchange service under the schedule of rates filed by the plaintiff with the defendant, together with the net earnings from rates for all other services comprising the plaintiff's entire business in the State of New Jersey, using depreciation rates found by the defendant stated in rate per cent. annual return upon the book cost of the entire [fol. 184] property of the plaintiff used and useful and reasonably necessary in rendering service by the plaintiff during the following periods would be at least:

For the year 1922, 10.44%

For the year 1923, 10.03%

For the year 1924, 8.51%

Defendant says that the net earnings derived by the plaintiff from its entire telephone business within the State of New Jersey under the rates for telephone exchange service now in effect, together with the net earnings from rates for other services, stated in the rate per cent annual return upon the book cost of the entire property of the plaintiff used and useful and reasonably necessary in furnishing said service, if the order of the defendant had been made effective in 1922, would have yielded more than 7.7 per cent; and if made effective in 1923, would have yielded more than 7.7 per cent; and if made effective in 1924, would have yielded more than 7.7 per cent; and if made effective in 1925, will yield more than 7.7 per cent for at least two years.

XII. The defendant denies that the telephone business of the plaintiff in the State of New Jersey has been conducted efficiently and economically during the period referred to in paragraph (XII) of the bill. Defendant says that the plaintiff's charges for depreciation in its expenses are excessive, unreasonable, unjust, and are greatly in excess of the actual depreciation. This defendant is without knowledge or information to form a belief as to the telephone business of the plaintiff without the State of New Jersey.

XIII. This defendant denies the allegations contained in paragraph (XIII) of the bill and says that an 8 per cent. return on the fair and reasonable value of the plaintiff's property used and useful and reasonably necessary in the rendition of service in the State of New Jersey is unreasonable and excessive, is more than necessary to attract new capital to the business of the plaintiff and will produce earnings available for dividends to its stockholders in excess of 8 per cent. on the outstanding stock of the plaintiff. The plaintiff enjoys a virtual monopoly in the State of New Jersey and is one of the associated companies of the Bell System which is a recognized monopoly furnishing telephone service throughout the United States. The American Telephone & Telegraph Company owns all of the stock, except qualifying shares, of the plaintiff company and receives, under an alleged contract with the plaintiff, 4.5 per cent. of the gross telephone revenues of the plaintiff and one of the services provided under the terms of said contract is rendering assistance in financing, which results and has resulted in a cost of securing money to the plaintiff during recent years far below that of other utilities in the State of New Jersey.

This defendant further says that the return to the plaintiff, specified by the decision and order referred to in the bill, is more than 8 per cent. on either the cost or fair value of the plaintiff's property.

XIV. The defendant denies the allegations contained in paragraph (XIV) of the bill and says that the net earning derived from plaintiff's entire property and business within the State of New Jersey, under the rates now and heretofore in effect, have reduced, for the years 1922, 1923 and 1924, at least 7.5 per cent. return on the fair and reasonable value of the property used and useful and reasonably necessary to the rendition of service in said

state, and more than 7.5 per cent. on the cost of the property used and useful and reasonably necessary to the rendition of service in said state.

XV. This defendant makes the same answer to the allegations contained in paragraph (XV) of the bill as it has to paragraph (XIV) of the bill, the same as if said answer was herein again repeated.

XVI. The defendant admits that the plaintiff is engaged in furnishing both intrastate and interstate telephone service and that the Interstate Commerce Commission, by order dated December 10th, 1912, adopted and promulgated the "Uniform System of Accounts For Telephone Companies" effective January 1st, 1913, and that said order includes the provisions stated in Vol. 33 of paragraph (XVI) and says that said order of the Interstate Commerce Commission also contains the following:

"The rate of depreciation should be fixed so as to distribute, as nearly as may be, evenly throughout the life of the depreciating property the burden of repairs and the cost of capital consumed in operations during a given month or year, and should be based upon the average life of the units comprised in the respective classes of property."

The defendant says that the plaintiff has not complied with said order of the Interstate Commerce Commission in that the plaintiff has not fixed a rate of depreciation based upon the average life of the depreciable property and the salvage as found by the plaintiff's experience with its property in the State of New Jersey.

The defendant further answering says, that the Interstate Commerce Commission is without authority to delegate the power of fixing rates of depreciation to the plaintiff. The plaintiff has failed to base its depreciation rates upon the average life and salvage of the depreciable property. The rates of depreciation found by the defendant were based on the testimony adduced before it, including average life and salvage of the plaintiff's property established by a study of its history and experience in the State of New Jersey, and said rates were found and fixed in accordance with Chapter 195 of the Public Laws of the State of New Jersey, 1911, and the amendments thereto and supplements thereof, and in accordance with the rules and regulations of the Interstate Commerce Commission.

The "Uniform System of Accounts for Telephone Companies" provided by the Interstate Commerce Commission and adopted by this defendant relates to accounting practices including the matters of depreciation expense and amortization of Landed Capital. This defendant denies that said "Uniform System of Accounts" fixes any rate of depreciation. The rates of depreciation found by this defendant and fixed in the decision and order annexed to the bill, for depreciable property used by plaintiff, in rendering service, located within the State of New Jersey were determined as hereinbefore stated. The plaintiff expressly stated to the defendant that it did not seg-

[fol. 186] regate or separate the allowances to be made for depreciation between its property located in the State of New Jersey devoted to intrastate and interstate service.

The defendant says that the plaintiff has at no time based its depreciation rates upon the average life of units comprising the several classes of property derived from a consideration of the plaintiff's history and experience.

The "Uniform System of Accounts" promulgated by the Interstate Commerce Commission requires the plaintiff to charge against account 413, "Realized Depreciation Not Covered by Reserves," which is a surplus account, losses arising from the retirement of the plant of the plaintiff not provided for in the reserve for accrued depreciation on January 1st, 1913. The plaintiff has wholly failed to comply with this requirement of the "Uniform System of Accounts" and in this respect the plaintiff has also failed to comply with the Uniform System of Accounts promulgated by the defendant.

Except as herein admitted, the defendant denies the allegations of paragraph (XVI) of the bill.

XVII. The defendant admits the enactment of Congress referred to in paragraph (XVII), but denies that the Interstate Commerce Commission has fixed any rates of depreciation applicable to the property of the plaintiff located in the State of New Jersey used and useful and reasonably necessary to render service. Defendant is without knowledge or information to form a belief as to the service upon the plaintiff of the notice referred to as being signed by George B. McGinty and says that said notice is not an order of the Interstate Commerce Commission and does not prescribe the rates of percentage to be applied by the plaintiff to its property located in the State of New Jersey as hereinbefore referred to. The defendant is without knowledge or information to form a belief as to the steps taken by the Interstate Commerce Commission to carry out paragraph (5) of section (20) of the said act of Congress.

XVIII. The defendant admits that the plaintiff has been required by law to conform to the "Uniform System of Accounts" promulgated by the Interstate Commerce Commission, but denies that the jurisdiction of said Interstate Commerce Commission is exclusive as to the matters referred to therein. This defendant denies that the act of Congress referred to in paragraph (XVIII) of the bill has occupied and pre-empted the field of governmental regulation to the exclusion of any jurisdiction of the defendant, particularly in the matter of fixing and determining rates of depreciation. This defendant further says that neither the Interstate Commerce Commission nor Congress has ascertained, fixed or regulated the rates of depreciation to be applied by the plaintiff to its property located in the State of New Jersey used and useful and reasonably necessary for the rendition of service in said state, and that the defendant has jurisdiction so to do under Chapter 195 of the Public Laws of the State of New Jersey, 1911, and the amendments thereto and supplements thereof.

[fol. 187] Except as herein admitted, the defendant denies the allegations of paragraph (XVIII) of the bill.

XIX. The defendant denies the allegations of paragraph (XIX) of the bill and that the rates fixed by the defendant to be charged by the plaintiff as expense of depreciation on account of its several classes of property and for amortization of Landed Capital are void for want of jurisdiction, or for any other reason or that said rates so fixed are in conflict with the orders of the Interstate Commerce Commission, or that said rates violate in any respect whatsoever the constitutional rights of the plaintiff or that said rates are in any manner whatsoever violative of the acts of Congress or the orders of the Interstate Commerce Commission.

The defendant denies that the provisions of its order requiring the plaintiff to keep its accounts in the manner directed in said order are void for any reason whatsoever. The defendant further denies that a compliance with the order of this defendant will result in a violation of the orders of the Interstate Commerce Commission and thereby incur any penalties under the Interstate Commerce Act, but on the contrary this defendant says that a compliance with its order can be carried out without any violation of the Interstate Commerce Act and in full compliance with the laws of the State of New Jersey.

The defendant admits that in case the plaintiff fails to comply with defendant's order the plaintiff will be required to do so under the provisions for such case made and provided by the laws of the State of New Jersey.

Except as herein admitted, the defendant denies the allegations of paragraph (XIX) of the bill.

XX. The defendant denies that the plaintiff's depreciation accounting was not regulated by any public authority prior to January 1st, 1913, but on the contrary says that depreciation rates and accounting were under full regulation and control by the defendant according to Chapter 195 of the Public Laws of the State of New Jersey, 1911, and the amendments thereto and supplements thereof.

The defendant denies that since January 1st, 1913, the depreciation accounting has been regulated by the orders of the Interstate Commerce Commission in that no rates or amount of depreciation have been prescribed or ordered by said Commission. The defendant is without knowledge or information to form a belief as to the allegations in paragraph (XX) of the bill wherein the plaintiff alleges the filing of annual reports with the Interstate Commerce Commission and that said reports have shown plaintiff's financial status and the rates being charged for depreciation and amortization. Defendant denies that the reports, if any, made by the plaintiff to the Interstate Commerce Commission have been at all times substantially accurate and correct and in accordance with the orders, rules and regulations of the Interstate Commerce Commission. Defendant denies that the plaintiff's accounting for depreciation and the depreciation reserve has been set up according to law and is not excessive, and on the contrary this defendant says that

the depreciation rates applied by the plaintiff are too large and have [fol. 188] the effect of not only completely providing for amortization of the cost of the plaintiff's property, but have produced an excessive and unrequired depreciation reserve which has been applied by the plaintiff to its capital account.

XXI. Answering the allegations in paragraph (XXI) of the bill, defendant says that the plaintiff is entitled to a reasonable rate of return upon its property in the State of New Jersey used and useful and reasonably necessary for the rendition of service. The defendant says that the depreciation and amortization expenses set up on the books of the plaintiff are unreasonable and excessive. Except as herein admitted, the defendant denies the allegations made in paragraph (XXI) of the bill.

XXII. Answering paragraph (XXII) of the bill, this defendant says that the fair value of the plaintiff's property used and useful as of June 30th, 1924, does not exceed \$76,370,000 and that the plaintiff is entitled to earn a fair return thereon of approximately \$5,750,000 which is slightly more than 7.5 per cent. upon said value. Defendant denies that said order intended "theoretically" to yield said return, but says that it does in fact and in effect yield the return hereinbefore mentioned; that the sum of \$5,750,000 is a fair return upon the value of the said property and that plaintiff will receive such return if a reasonable and proper treatment of depreciation is followed in its accounting. The defendant denies that the order of the defendant fixes the expense of depreciation and amortization at an inadequate amount, thereby increasing the current net earnings by a corresponding amount. On the contrary, the defendant says that the plaintiff, in its accounts, has overstated the amount of its depreciation expense by the application of depreciation rates that are too large and has thus decreased the net earnings by an amount corresponding to the excessive and unreasonable charges for depreciation.

The defendant says that the excessive accumulations in the depreciation reserve of the plaintiff on December 31st, 1924, amount to approximately \$5,300,000. The defendant denies that the charges to expenses for depreciation and amortization under the order of the defendant will be inadequate. The defendant says that compliance by the plaintiff with the defendant's order will make no reduction in plaintiff's depreciation reserve, but will maintain said reserve substantially as it is until the property as the result of further depreciation requires the amount of the reserve already accumulated by the plaintiff. The defendant denies that the order of the Board deprives in any way the plaintiff of its property without due process of law or disregards or violates the plaintiff's rights under the Fourteenth amendment of the Constitution of the United States.

Except as herein admitted, the defendant denies the allegations of paragraph (XXII) of the bill.

XXIII. The defendant denies the allegations contained in paragraph (XXIII) of the bill.

XXIV. The defendant answering paragraph (XXIV) of the bill says that its order does not require the plaintiff to continue in effect rates for telephone service that will not afford the plaintiff a fair [fols. 189 & 190] return upon the fair and reasonable value of its property used and useful and reasonably necessary for the rendition of service.

The defendant denies that if the order of the defendant is in force plaintiff will be deprived from earning any return in excess of 0.40 per cent. upon the fair and reasonable value of its telephone property in the State of New Jersey used and useful in furnishing intrastate service and from earning any rate in excess of 0.46 per cent per annum upon the cost of said property. The defendant says that if the order made by it is complied with by the plaintiff, the plaintiff's net return upon its property used and useful and reasonably necessary in the rendition of service will be at least 7.5 per cent. on the reasonable value of said property and more than 7.7 per cent. on the cost thereof.

Except as herein admitted, the defendant denies the allegations made in paragraph (XXIV) of the bill.

XXV. Answering paragraph (XXV) of the bill, the defendant says that it contemplates enforcing its order dated December 31st, 1924, in accordance with the provisions of Chapter 195 of the Public Laws of the State of New Jersey, 1911, and the amendments thereto and supplements thereof, and that the enforcement of said order will not submit the plaintiff to confiscation of its property without due process of law and in violation of any of its constitutional rights, nor will it subject the plaintiff to irreparable loss and damage but on the contrary will provide the plaintiff with a just and reasonable return upon the fair and reasonable value of its property in the State of New Jersey used and useful and reasonably necessary for the rendition of service.

Except as herein admitted, the defendant denies the allegations made in paragraph (XXV) of the bill.

XXVI. Answering paragraph (XXVI) of the bill, the defendant says that so far as this defendant has knowledge or information to form a belief, the plaintiff's subscribers will expect to pay only legal and authorized rates for telephone service and will properly refuse payment for any rate for service that is unreasonable and excessive and not legally effective. This defendant is without knowledge or information to form a belief as to the exact number of plaintiff's accounts with subscribers in the State of New Jersey or the present average monthly bill rendered to them on account of exchange service.

Except as herein admitted the defendant denies the allegations made in paragraph (XXVI) of the bill.

XXVII. The defendant denied each and every allegation in the bill not herein admitted, controverted or specifically denied.

The defendant prays to be hence dismissed with its reasonable costs and charges in this behalf most wrongfully sustained.

Thomas Brown, Solicitor for and of Counsel with Defendant Board.

[fols. 191 & 192] [File endorsement omitted]

[fol. 193] IN UNITED STATES DISTRICT COURT

[Title omitted]

AFFIDAVIT OF CYRUS G. HILL ON DEPRECIATION—Filed March 16, 1925

STATE OF NEW JERSEY,
County of Essex, ss:

Cyrus G. Hill, being duly sworn, deposes and says:

I reside in the City of Chicago, State of Illinois. I graduated from Yale College with the degree of Bachelor of Arts in 1912, and obtained the degree of Master of Electrical Engineering from Harvard University in 1914. From the year 1914 to 1919, I was employed as an engineer by the Central Group of Bell Telephone Companies, having offices in Chicago, Ill. In this capacity I was engaged in engineering work dealing with the maintaining and construction of plant for Bell Telephone Companies operating in the States of Illinois, Michigan, Wisconsin, parts of Ohio and Indiana. During the years 1917 and 1918, I served as a Second Lieutenant in the Air Service in France. In addition to other duties, I had charge of electric lighting and power and telephone construction work for the large aviation fields at Tours and Souge, France. In the year 1919, I became a partner of J. G. Wray, in a consulting engineering business under the firm name of J. G. Wray & Co. specializing particularly in telephone work. Since 1919, I have been employed as a member of this firm by many Bell and Independent Telephone Companies, municipalities, states and governments. The more important work includes the following:

Employment by the Government of the Province of Alberta, Canada, to make a valuation and engineering studies for the Government owned telephone system.

By the Northwestern Telephone Exchange Company operating in the State of Minnesota in connection with their application for increased rates. This work included a check of the company's valuation of its property and a study of the depreciation of the company's property, including both the accrued depreciation and annual rate of depreciation.

By the North Dakota Independent Telephone Company to make an appraisal of its property and assist in the presentation of its rate case before the Public Utilities Commission of North Dakota.

By the Western Electric Telephone System of Iowa to make an inventory and appraisal of its property for purposes of organization and financing.

By the Home Telephone and Telegraph Company of Fort Wayne, Ind., to make a fundamental plan for the City of Fort Wayne and to engineer a complete re-construction of the company's plant, including the addition of several million dollars' worth of new plant and equipment. Work for this company also included an inventory and appraisal of its property and preparation of its application for increased rates before the Public Utilities Commission in the State of Indiana and, later, assistance in the company's case in the Federal Court.

By the Cities of Buffalo and Syracuse in New York State in the matter of an increase in rates by the New York Telephone Company. This work consisted principally in a check of the company's valuation and a separation of toll and exchange property and expenses.

By the City of New York in the matter of an application by the New York Telephone Company for increased rates before the Public Service Commission of New York State. In connection with this case, I made a comprehensive study of the accrued and annual depreciation of the property of the New York Telephone Company in New York City, based upon an analysis of the company's history and experience.

By the Northwestern Bell Telephone Company in the State of Nebraska to make a study of the depreciation of the company's property, based upon the company's history and experience. The results of this study were presented by me in behalf of the company before the Federal Court in the State of Nebraska.

By the Indiana Bell Telephone Company in connection with its application for increased rates before the Public Utilities Commission, and later in connection with the company's case in the Federal Court. This work consisted of a check of the company's valuation of its property and an exhaustive study of depreciation, both accrued and currently accruing.

By the Public Service Commission of New York State, to make a study of the depreciation of the New York Telephone Company's property throughout the State of New York, based upon the history and experience of the company.

By the Attorney General of the State of Mississippi in a case in the Federal Court, involving the valuation of the property, separation of toll and exchange property and expenses and a study of depreciation.

I am now employed as a member of the firm of J. G. Wray & Co., by the State of Washington, and the Cities of Seattle, Tacoma and Spokane in the matter of an application for increased rates by the Pacific Telephone & Telegraph Company and the Home Telephone & Telegraph Company of Spokane before the Public Service Commission of Washington, and in connection with an injunction case in the Federal Court. I am engaged in the preparation of an ex-

haustive study of depreciation of the telephone plant in the State of Washington and in the Cities of Seattle, Tacoma and Spokane, based upon the history and experience of the company.

By the City of New York in connection with the New York Telephone Company's case now pending in the Federal Court for the Southern District of New York.

Study of Plaintiff's Property in the State of New Jersey

I have been employed almost continuously since May, 1924, by the Board of Public Utility Commissioners of the State of New Jersey on an investigation of the property and business of the New York Telephone Company in the State of New Jersey in connection with the application of that company for increased rates. [fol. 195] As a part of this work, I have investigated the history and experience of the New York Telephone Company and its predecessor telephone companies in the State of New Jersey from the earliest available records to the end of the year 1924. The records of the company's operations as regards plant constructed, plant retired and salvage realized thereon have been analyzed by me in such a way as to exhibit the company's experience as to the average life of each class of plant and the salvage to be recovered at the retirement of plant of each class. These investigations form the basis for a depreciation study, in which are determined the annual rate of depreciation of the company's property in the State of New Jersey and the reserves for accrued depreciation which are required to provide adequately for the retirement of the company's present plant at such time as it is removed from service.

Rates of Depreciation

The rates of depreciation of the various classes of plant included in all of the company's present depreciable property in New Jersey have been found from the above described depreciation study to be as follows:

Account	Average annual deprecia- tion rate %
Exchange Right of Way.....	5.26
Toll Right of Way.....	4.55
Buildings	2.67
Central Office Equipment.....	5.00
Other Equipment at Central Offices.....	5.38
Station Apparatus	2.95
Station Installations	1.00
Interior Block Wire.....	4.00
Private Branch Exchange.....	3.14
Booths and Special Fittings.....	3.47
Exchange Pole Lines.....	7.66
Exchange Aerial Cable.....	4.45

Account	Average annual depreciation rate %
Exchange Aerial Wire.....	10.50
Exchange U. G. Conduit, Main.....	1.33
Exchange U. G. Conduit, Subs.....	4.00
Exchange °. G. Cable, Main.....	1.95
Exchange U. G. Cable, Subs.....	4.00
Exchange Submarine Cable.....	4.54
Toll Pole Lines.....	5.00
Toll Aerial Cable.....	2.42
Toll Aerial Wire.....	3.45
Toll U. G. Conduit.....	1.33
Toll U. G. Cable.....	2.17
Toll Submarine Cable.....	3.75
Office Furniture and Fixtures.....	5.27
Interest During Construction.....	4.28
Store Equipment.....	5.75
Stable and Garage Equipment.....	15.46
Tools and Implements.....	13.33

The average annual expense of depreciation, being the amount which should properly be set aside from earnings to cover depreciation [fol. 196] tion of the company's property is found by applying the above depreciation rates to average book cost of plant of each class to be as follows:

For the year 1923.....	\$2,462,957
For the year 1924.....	2,678,386

The amounts set aside by the New York Telephone Company to cover depreciation of its property in the State of New Jersey for the corresponding years are as follows:

For the year 1923.....	\$3,125,199
For the year 1924.....	3,762,612

The excess of the company's allowance for depreciation over and above the depreciation accruing on the property for those years is:

For the year 1923.....	\$662,242
For the year 1924.....	1,084,226

Depreciation Reserves

If amounts equal to the depreciation accruing in the plaintiff's present plant in the State of New Jersey are set aside each year from the year 1924, to the retirement of the present property, the total of such accruals will be less than the book cost of the plant retired, less salvage. For this reason, plaintiff should have at all times a depreciation reserve equal to the difference between the book cost of plant to be retired less the net salvage and the total of the annual

allowance for depreciation which will accumulate against that same plant in the future up to the time of its retirement. Reserves for this purpose are provided under the Uniform System of Accounts prescribed by the Interstate Commerce Commission for Class A telephone companies by Account No. 102 "Reserve for Accrued Depreciation" and Account No. 103 "Reserve for the Amortization of Intangible Capital," which relates largely to the company's right of way accounts. I have computed the correct amount of all these depreciation reserves and find it to be, as of December 31, 1924, \$13,869,005. The amount of these reserves as shown on the plaintiff's books for the New Jersey Division, as of December 31, 1924, is \$19,163,626. The excess of plaintiff's reserves over and above the reserves required for the ultimate retirement of their present property is \$5,294,621.

Average Life of Plaintiff's Property

The amount of depreciation accruing in the plaintiff's property and the required reserve for accrued depreciation are determined by:

1. The book cost of the property to be retired in the future.
2. The average life of that property.
3. The net salvage to be recovered when that property is retired.

The annual expense of depreciation is equal to the book cost to be retired less the net salvage, divided by the average life. The book cost for each class of plant is shown by the company's ledger accounts for fixed capital. The average life of each class of plant has been determined by me by an analysis of the company's records of plant placed and retired during each year, from the year 1923, back to about the year 1894, which is the earliest year for which records are available. A careful study of all conditions which might cause the average life of plant in the future to differ from the past experience of the company disclosed that the average life of a large part of the plaintiff's property has been growing longer from [fol. 197] year to year and that this change is still continuing. The average life of the present plant as a whole is longer than that of plant which has been retired in the past. The lengthening of average life will cause a decrease in the rate of depreciation of the company's property, whereas a shortening of average life would cause an increase in the depreciation rate. In determining the depreciation rates above set forth, both the average life obtained by the company's plant which has been retired and the length of life thus far obtained by the plant in service are included. The rates of depreciation above listed are therefore higher than the true rate of depreciation of the present property, and are conservative and favorable to the plaintiff. The rates of depreciation herein listed are the same as those used by the defendant Board of Public Utility Commissioner of New Jersey in its order of December 31, 1924.

Salvage

In determining the net salvage which is a factor in the average rate of depreciation of the plaintiff's property, the company's experience as regards salvage recovered from plant retired during the ten-year period from 1914 to 1923, was analyzed by me. The effects of changes in price levels during that period were considered. A forecast was made of the probable salvage which will be obtained in the next four or five years, or for as long a period in the future as can be forecast with reasonable accuracy. In the case of many classes of plant, the average salvage for the last ten years, expressed as a percentage of the plant retired, was considered by me to give the best indication of the percentage of salvage which may reasonably be expected in the near future.

Period to Which Depreciation Rates Apply

The average life and the salvage which form the basis for the depreciation rates determined by me, are less than the most probable average life and salvage relating to the company's present property under conditions expected to exist during the next four to six years. Because of the liability to error, in attempts to forecast conditions in the distant future, the plaintiff's requirements to meet the depreciation of its property will best be provided for through depreciation rates which measure the estimated average current depreciation in the plant and are revised frequently. Unforeseen changes in conditions affecting the average life and salvage can thus be met promptly and the accumulation of large excesses or deficiencies in the depreciation reserve can be avoided.

Growth of the Depreciation Reserves

The loss incurred by the plaintiff when its property is removed from service should be completely amortized by the accumulation of a depreciation reserve against that property up to the time of its retirement. The accumulated depreciation reserve associated with each unit of plant should exactly equal the book cost of that unit, less the net salvage at the time the unit is retired from service. There should be neither excess nor deficiency in the depreciation reserve. If there be deficiency, the plaintiff will suffer loss. If there be excess, the plaintiff will have obtained an addition to its [fol. 198] capital through overcharges to its operating expense accounts.

The plaintiff's present depreciation reserve is, as above stated, in excess of requirements for the retirement of the present property with which that reserve is associated. The depreciation rates used by the plaintiff in determining the annual expense of depreciation charged to operating expenses and credited to depreciation reserve are in excess of the present average rate of accrual of depreciation in the plaintiff's property. If the plaintiff continues to use its present depreciation rates as set forth in plaintiff's affidavits (p. 94) for de-

termining the credits to depreciation reserve associated with the present property, that reserve will increase far beyond its requirements. In less than 10 years, the plaintiff's depreciation reserve associated with the present property will be greater than the part of that property remaining to be retired less salvage. In less than 20 years that reserve will have increased to an amount several hundred per cent greater than the property to be retired with which it is associated. If the annual credits to depreciation reserve associated with the present plant are computed from the depreciation rates ordered by the defendant, as herein above listed, the existing depreciation reserve will be increased to 130 per cent of the present plant remaining to be retired at the end of the year 1943, and before the year 1953, the reserve will be several hundred per cent greater than the plant to be retired with which it is associated.

The growth of the present depreciation reserve expressed as a percentage of the corresponding part of the present plant remaining in service is shown in Exhibit No. I attached hereto and made a part hereof. The said depreciation reserve percentages computed under two assumptions: first, the continued application of the plaintiff's depreciation rates; second, the application of the depreciation rates specified in defendant's order of December 31, 1924. Exhibit No. I shows also the required, or normal depreciation reserve, which increases from a present value of 27 per cent of the present depreciable property less net salvage, to 100 per cent of the property at the time the last remaining units of the present plant are retired from service.

The amount in dollars of the present depreciable plant less salvage, the parts of that plant remaining in service in 1933, 1943, 1953 and 1963, the plaintiff's depreciation reserve associated therewith in each of those years and the corresponding required or normal depreciation reserve are shown in Exhibit No. II, which is made part hereof. When the present plant has been completely retired, the plaintiff will have in its possession for the retirement of that plant no longer existing a depreciation reserve of over \$15,000,000. The plaintiff will obtain, thereby, an addition of \$15,000,000 to its capital account over and above all amounts needed to keep plaintiff's investment intact.

The defendant's order of December 31, 1924, provides a remedy for this excessive accumulation of depreciation charges by retarding the growth of the plaintiff's depreciation reserve until the currently accruing depreciation in the property shall have brought the required or normal depreciation reserve to approximate equality with the existing depreciation reserve.

Exhibit No. III which is made part hereof, shows graphically the [fol. 199] results of the application of the defendant's order, starting January 1, 1925. Compliance by the plaintiff with that order will provide reserves and annual allowances for depreciation adequate to meet the retirements of the plant as they occur and to leave an excess of about one-half million dollars in the depreciation reserve when the present plant, with additions to the end of 1926, has been

taken out of service. Exhibit III deals with the plant as of December 31, 1924, increased by net additions to the end of the year 1926. Similar results would be obtained for the plant in service in 1927, 1928 and succeeding years and the depreciation reserves associated therewith.

Failure of Plaintiff to Comply with Rules Governing Depreciation in the Uniform System of Accounts

The plaintiff has stated that its accounts are kept in accordance with the "Uniform System of Accounts for Telephone Companies" prescribed by the Interstate Commerce Commission, effective on January 1, 1913, and also claims to have been so keeping these accounts since that date. In regard to depreciation the plaintiff claims that the instructions issued by the Interstate Commerce Commission in its Uniform System of Accounts are specific as to the method of handling the depreciation accounts and the amount which shall be set aside for depreciation.

The text of the Interstate Commerce Commission's instructions pertaining to depreciation in the "Uniform System of Accounts for Telephone Companies" (p. 67, paragraph 23), is as follows:

"Telephone companies should include in operating expenses depreciation charges for the purpose of creating proper and adequate reserves to cover the expenses of depreciation currently accruing in the tangible fixed capital. By expense of depreciation is meant—

(a) The losses suffered through the current lessening in value of tangible property from wear and tear (not covered by current repairs).

(b) Obsolescence or inadequacy resulting from age, physical change, or supersession by reason of new inventions and discoveries, changes in popular demand, or public requirements, and

(c) Losses suffered through destruction of property by extraordinary casualties.

The amount charged as expense of depreciation should be based upon rules determined by the accounting company. Such rules may be derived from a consideration of the company's history and experience. Companies should be prepared to furnish the Commission, upon demand, the rules and a sworn statement of the facts, expert opinions, and estimates upon which they are based.

The estimate for depreciation of physical property should take into account—

(a) The gradual deterioration and ultimate retirement of units of property which may be satisfactorily individualized, such as buildings, machines, valuable instruments, etc., to the end that by the time such units of property go out of service there shall have been accumulated a reserve equal to the original money cost of such property plus expenses incident to retirement less the value of any salvage.

(b) The depreciation accruing in property which can not be readily individualized, such as pole lines, wires, cables, or other continuous structures, where expenditures for repairs or replacements of individual parts ordinarily are not actually made until the later years of the life of such property, and when made may, therefore, be classed as extraordinary repairs.

The rate of depreciation should be fixed so as to distribute, as nearly as may be, evenly throughout the life of the depreciating property the burden of repairs and the cost of capital consumed in operations during a given month or year, and should be based upon the average life of the units comprised in the respective classes of property.

The amount estimated to cover the expense of depreciation of fixed capital should be charged monthly to account No. 108, 'Depreciation of Plant and Equipment' (or to the appropriate clearing account or accounts), and concurrently credited to account No. 102, 'Reserve for Accrued Depreciation—Cr.'

Account No. 413, 'Realized Depreciation not Covered by Reserves,' is provided in the Corporate Surplus or Deficit account for charges for realized depreciation on tangible fixed capital retired when such depreciation occurred prior to the establishment of account No. 102. 'Reserve for Accrued Depreciation—Cr.' or has not been provided for by credits to that account."

It should be noted that, whereas no definite rates for depreciation are specified in the above, the method to be followed in determining such rates is definitely stated as follows:

"The rate of depreciation should be fixed so as to distribute, as nearly as may be, evenly throughout the life of the depreciating property the burden of repairs and the cost of capital consumed in operations during a given month or year, and should be based upon the average life of the units comprised in the respective classes of property."

The factors which must be determined, therefore, as a basis for the expense of depreciation are: First, the original cost of the property less the salvage, which constitutes the "Cost of Capital Consumed in Operations"; and Second, the average life for each class of property, which determines the proportion of the cost of capital consumed and the operations to be allocated to each year.

Respecting its accounting for the depreciation of the company's property in the State of New Jersey, the company has failed to follow the instructions of the Interstate Commerce Commission in the following respects:

First: On the evidence presented to the defendant and the affidavits on behalf of the plaintiff in this case, no adequate investigation has been made by the plaintiff either of the average life of the various classes of plant in use in New Jersey, or of the salvage recovered from plant retired in New Jersey.

Second: The provision in the Uniform System of Accounts covering "Realized Depreciation not Covered by Reserves" (Account No. 413), as quoted above, has not been followed by the plaintiff, and is not now used by them. Detailed instructions relating to Account No. 413 are given on page 58, of the "Uniform System of Accounts for Telephone Companies," as follows:

"Charge to this account the realized depreciation (i. e., the difference between the original cost and the salvage, if any) on tangible fixed capital retired, if such depreciation has not been provided for [fol. 201] through a depreciation reserve. This includes such portion of the realized depreciation on any physical property which was installed prior to the period for which the reserve was established as is due to life in service before that period. This portion may be estimated on the basis of the proportion which the life in service of the property in question prior to the period for which the reserve was established bears to its entire life in service" (see sec. 23, p. 67).

Answer to Affidavit of Andrew Sangster on Depreciation Accounting

Andrew Sangster, in his Affidavit on Depreciation Accounting, page 118, criticizes the Order of the Defendant as being inconsistent with rulings of the Interstate Commerce Commission regarding Depreciation Accounting. He states that: "The regulations above quoted only permit to be charged against the credit set up in the Depreciation Reserve, actual retirements of property at its actual cost, less net salvage, at the time the property is retired. The order of the Board would in effect require the plaintiff to charge against the credit to the reserve for depreciation something entirely different, namely, an estimated amount of a theoretical excess in the reserve for depreciation." The last statement is erroneous and can result only from an entire misinterpretation of the Defendant's order, since nowhere in that order is it suggested that the excess in the depreciation reserve should be charged against accumulated credits to the reserve.

Mr. Sangster's chief argument in support of his position concerns the fact that the Interstate Commerce Commission evidently intended the depreciation reserve accumulated after January 1, 1913, to be utilized to meet that part of the realized depreciation which had accrued since January 1, 1913. He states in his affidavit (p. 118), "The Uniform System of Accounts definitely prescribes the procedure to be followed where the amounts accumulated in these reserves are inadequate to cover the realized depreciation on tangible fixed capital when such capital is relinquished, retired or destroyed, or the cost of Landed Capital When such property is taken out of service." The Interstate Commerce Commission rule state that the portion of the realized depreciation which was accrued before January 1, 1913, and is, therefore, not covered by reserves accumulated since January 1, 1913, "may be estimated on the basis of the proportion which the life in service of the property in question prior to the period for which the reserve was established bears to its entire

life in service." Sangster further states in affidavit, page 120, "It is obvious that if Accounts 413 and 414 (applying to intangible capital) had not been provided for the special purpose of absorbing differences between the amounts accumulated in the reserves and the realized depreciation not covered by such accumulation, it would have been necessary to increase the charges to Expense of Depreciation or to Amortization of Intangible Capital so as to maintain proper and adequate reserves." This statement is incorrect and contrary to the facts, because plaintiff has not complied with the rules referred to. My investigation of the plaintiff's Depreciation Reserves on December 31, 1912, has shown that they were less than half of their normal or required amount. The deficiency of the [fol. 202] reserves as of December 31, 1912, amounted to over one million dollars. A further study of the proportion which the life in service of the property in question prior to December 31, 1912, bears to its entire life in service, discloses that of the above deficiency in the Depreciation Reserve more than \$911,000 is applicable to plant in service in 1912 and retired between 1913 and 1923 inclusive. According to the Uniform System of Accounts, this amount should have been charged to Accounts 413 and 414 of the Corporate surplus or Deficit Account, and not to Accounts 102 and 103, the Reserve for Accrued Depreciation and Reserve for Amortization of Intangible capital, respectively. My investigation has proved that the plaintiff did not follow the Uniform System of Accounts in this respect: that realized depreciation on plant retired between 1913 and 1923, inclusive, has been charged to the reserve for accrued depreciation, regardless of whether a part of the realized depreciation was accrued before December 31, 1912, and was not covered by reserves at that time. Had Interstate Commerce Commission rules been followed, the annual depreciation charges between 1912 and 1924 necessary to maintain proper and adequate reserves would have been lower by nearly \$1,000,000, and the current expense of depreciation would now be less than that ordered by the Defendant by more than 5.35 per cent.

Mr. Sangster's principal argument against the defendant's order relating to depreciation is based upon a ruling of the Interstate Commerce Commission in its Uniform System of Accounts which the plaintiff has not followed, with which it is not now complying, and has, so far as is disclosed in the testimony or the exhibits presented to the defendant or in the affidavits on behalf of plaintiff in this case, no intention of complying.

Answer to Affidavit of G. W. Whittemore on Depreciation

The affidavit of G. W. Whittemore on depreciation (plaintiff's affidavits, pp. 87-106) is devoted principally to a criticism of certain average life and salvage figures applying to plaintiff's property in New Jersey which were used by the defendant. These average life and salvage figures were developed by me in the depreciation study of the New Jersey property above described. The plaintiff

has not and does not in said affidavit find the average life or salvage of any class of its property in New Jersey in accordance with the requirements of the Interstate Commerce Commission. The depreciation rates given in plaintiff's affidavit (pp. 94 and 95) are the rates applied by plaintiff to its entire property, both in New York State and in New Jersey. As a result of my studies, covering the last four years, of the plaintiff's property and records bearing upon depreciation in New York and New Jersey, it is my opinion that conditions affecting the life and salvage of telephone plant in the two states are substantially different. In my opinion, depreciation rates which might measure correctly the annual depreciation of plaintiff's property in New York would not also be a correct Statement of the annual depreciation of plaintiff's property in New Jersey. The depreciation rates given on page 94 of Mr. Whittemore's affidavit [fol. 203] are as a whole substantially higher than the rate of depreciation of plaintiff's property in New Jersey, which was found by my study of the average life and salvage of that property.

The following facts are fundamental to a consideration of Whittemore's criticisms of the average life and salvage figures used by the defendant in fixing depreciation rates for the plaintiff's New Jersey property:

1. The average life used by defendant for each class of plant is, with minor exceptions, the average life of all plant constructed by the plaintiff in New Jersey, up to December 31, 1923, including both plant in service and plant which has been retired in years past. The average life so determined is in most cases shorter than the average life of property now in service, and the depreciation rates ordered by defendant are to this extent higher than the true average rate of accrual of depreciation in the present property. Said rates are substantially higher than the probable average rate of depreciation of plant to be placed in the future. Were an estimate required of the rate of depreciation for a period of 15 to 20 years in the future, the average life of the property would be longer and the rate of depreciation would have been lower.

2. The salvage used by the defendant for each class of plant is the percentage salvage which may reasonably be expected during the next three to six years. The percentage salvage to be recovered 15 or 20 years in the future might be higher or lower than the salvage used by the defendant.

3. A forecast of either the average life or the salvage relating to plaintiff's property as it will be from 15 to 20 years in the future would be largely speculative. By basing the current depreciation rates upon known conditions in the past and present, and upon the future in so far as it can be forecast with reasonable certainty, the question of currently accruing depreciation becomes a matter determinable with reasonable accuracy.

The correctness and substantial accuracy of the method used by me in analyzing the plaintiff's experience to determine average life has not been questioned by the plaintiff, except in the cases of Cer-

tral Office Equipment and Buildings. In Whittemore's affidavit (p. 99), it is stated:

"The actuarial method used by the defendant for determining the average life expectancies, while suitable to problems involving large numbers of similar initially complete units, like ten thousand, or more, of human lives, poles, feet of cable, or subscribers' sets (Account 231), is forced into an improper use when applied, as by defendant, to a relatively small number (about 50), of individually varying, initially incomplete and constantly growing or changing items of installations."

With the two exceptions above noted the correctness of the average life expectancies for plant of the various classes underlying the defendant's findings as to depreciation rates, may be considered as conceded by the plaintiff. The cases of Central Office Equipment and Buildings, will be considered in detail later.

In Exhibit P. 101, presented by Whittemore in the hearing before the defendant, he points out that for 21 classes of plant out of [fol. 204] a total of 28 classes, the rates and annual expense of depreciation found by the defendant, based upon the above-described depreciation study, differed from the plaintiff's present rates and annual expense of depreciation by only one-tenth of one per cent. For 21 classes of plant the methods used for determining the average life and salvage from the plaintiff's experience, have produced results which the plaintiff believes to be correct.

Whittemore finds the salvage percentages determined in the study for four classes of plant to be too high (see Whittemore affidavit on depreciation, pp. 98 to 103). No explanation is given by Whittemore as to why the same method of analysis should give substantially correct results for salvage in the case of 21 classes of plant and erroneous results for four classes. The objections which Whittemore raises to salvage, in the case of station apparatus, private branch exchanges, and exchange underground cable subsidiary (affidavit, pp. 102-105), would, if valid, apply with equal force to the other 21 classes of plant.

Taking up in detail the four classes of plant mentioned in Whittemore's affidavit (pp. 98 to 103), the unsoundness of Whittemore's arguments against the estimated net salvage percentages used by the defendant may be shown as follows:

Station Apparatus

Whittemore bases his argument on the fact that net salvage for station apparatus for the year 1923, 76.63 per cent., is lower than the figure of 82 per cent. used by the defendant. The average salvage for the ten-year period, 1914 to 1924, was about 82 per cent. The plaintiff uses a net salvage of 73 per cent. in its depreciation rates. Whittemore's argument is faulty because experience shows that the percentage net salvage fluctuates widely from year to year, and that the salvage recovered in a single year or a short period of years is not a good criterion of the salvage to be expected in the

future. For instance the salvage on station apparatus in 1916 was eleven per cent. above that in 1914, although the cost of station apparatus and the book cost per unit were approximately constant during that period. A decrease of eleven per cent. below the defendant's figure of 82 per cent. would give approximately 74.5 per cent., which is lower than the salvage in 1923.

The plaintiff claims in Exhibit P. 27, in Structural Value, at the hearing before defendant, that because a large number of subscribers' sets are currently returned from service repaired, and reinstalled, the condition of the sets retired, as indicated by the cost of repairs, is a reliable indication of the condition of the subscribers' sets in service. The average cost of repairs to make the retired sets as good as new was found to be 10.2 per cent. of the reproduction cost (Exhibit P. 28, p. 26, at hearing before defendant). Whittemore testified that the addition to this percentage to allow for the few sets that are junked would be very small. So unimportant was the correction that no change was made by the plaintiff in its structural value estimate. If all repairs to subscribers' sets were charged to depreciation, the salvage on station apparatus [fol. 205] should be not far from 100 per cent., minus 10.2 per cent., or 89.8 per cent., which is 7.8 per cent. higher than the salvage used by the defendant. In fact a part of these repairs are charged to current maintenance, which makes the expected salvage somewhat above 89.8 per cent. Since these figures are on a reproduction cost basis, changes in price levels and in book cost per unit are not concerned.

Private Branch Exchanges

For Private Branch Exchanges Whittemore refers to his arguments already presented for Station Apparatus (affidavit, p. 103). There is this important difference, that the net salvage actually recovered on Private Branch Exchange during the year 1923 was 80.68 per cent., whereas the figure used by the defendant was 78 per cent. Whittemore's argument that the 1923 salvage for Station Apparatus is lower than the salvage used by the defendant does not apply to Private Branch Exchanges. This fact proves that Whittemore's principal argument against the defendant's findings of depreciation for these two classes of plant is based merely upon accidental annual fluctuations in salvage percentages, and is without substantial foundation.

In Exhibit P. 28, p. 31, at the hearing before defendant, the plaintiff states that "In its general characteristics and conditions of service, private branch exchange apparatus corresponds closely to that found at other subscribers' stations, Account 231," and "The Method used in determining the Structural value of Station Apparatus is regarded as equally suitable to the case of private branch exchanges." The plaintiff estimates the cost of repairs to make retired private branch exchange equipment as good as new, including the proper allowance for equipment junked, to be 12.8 per cent. If all such repairs were charged to depreciation the gross salvage

would be 100 per cent. minus 12.8 per cent., or 87.2 per cent. If we deduct from this the cost of removal, which in the years 1922 and 1923 averaged about 3.6 per cent., the net salvage for Private Branch Exchanges becomes 83.6 per cent., or 5.6 per cent. higher than salvage used by the defendant. This is estimated on a reproduction cost basis throughout, so that changes in prices and book cost per unit are not concerned.

Exchange Underground Cable Subsidiary

As an argument against the net salvage percentage of 18.1 per cent. used by the defendant and for the 6 per cent. used by plaintiff, Whittemore states (affidavit, p. 103), that the average salvage before the war (presumably years 1914 and 1915) was 8.7 per cent.; that the salvage during the war years (1916 to 1921 inclusive) was 25.7 per cent., and that the recent experience (years 1922-1923) shows a salvage of 10.2 per cent. In considering these figures it should be remembered that the average cost of cable during the years 1916 to 1921 inclusive, was only about 25 per cent. above the cost in 1913, while the original cost of plant retired, as estimated by plaintiff, varied very little during these years. Experience has shown that the percentage increase in salvage during a period of rising prices [fol. 206] is less than the percentage increase in price levels. Assuming, as an extreme condition, that the two were equal, we would have for the salvage which would have been recovered during the war period, at 1913 cost levels, 25.7 per cent. divided by 125, or 20.6 per cent., which is 2.5 per cent. higher than the salvage used by the defendant. Again, Whittemore is basing his argument upon salvage recovered during short periods, such as one or two years, which as before stated, is not a reliable measure of the salvage to be recovered in the next few years.

Central Office Equipment—Salvage

In considering the salvage on Central Office Equipment, it must be remembered that the amount recoverable on small piece-meal retirements scattered here and there among a number of central offices is, because of the high cost of removal, very much less than the percentage salvage recovered when larger units or entire central offices are retired. During the last ten years comparatively large retirements were made in the years 1916 and 1920, the corresponding net salvage recovered being approximately 41 per cent. and 63 per cent. respectively. The net salvage recovered, during the ten-year period from 1914 to 1923 inclusive, averaged 34 per cent. of the original cost of plant retired. The salvage on Central Office Equipment during the years 1921 to 1924, which Whittemore states (affidavit, p. 101) amounts to 4.52 per cent., consists largely of piece-meal retirements of equipment in small amounts. The fact that this salvage is lower than that realized in previous years is not in itself an indication that "salvage percentages in recent years have shown a marked shrinkage," as stated by Whittemore. As fur-

ther proof of this fact, we have in the year 1923 the retirement of the Atlantic City toll board as a whole, on which the net salvage recovered amounted to approximately 30 per cent.

In regard to a possible decrease in the reuse value of Manual Central Office Equipment, due to the introduction of Machine Switching, there is as yet no indication of a general plan on the part of the plaintiff for the replacement of all Manual Central Offices by Machine Switching in territories such as the State of New Jersey. Even in the City of New York where a definite policy, according to plaintiff's statement, has been adopted for the introduction of Machine Switching Central Office Equipment, very large additions to Manual Equipment are still being made, both in existing offices and in new Manual Central Offices. The probability of Central Offices of the Manual type being supplanted by machine switching offices to such an extent as to eliminate the reuse value of Manual Central Office Equipment appears very uncertain and remote. Whittemore has stated before the Defendant (testimony, p. 2595), that his judgment figure of 10 per cent. for salvage on Central Office Equipment is based largely upon conditions as he expects them to be from 15 to 30 years in the future. He has offered no criticism of the salvage used by the defendant (20 per cent.), as representing the amount to be recovered from both piece-meal and large scale retirements of Central Office Equipment during the next four to six years. In another part of his testimony (p. 2587), Whittemore has stated [fol. 207] that in fixing depreciation rates he would determine the average life and the salvage which can be reasonably foreseen for the next two or three years, and would revise these estimates frequently, thereby avoiding large errors in the depreciation accrued as a result of inaccurate forecasts of conditions in the distant future.

Average Life—Central Office Equipment

As heretofore stated, Whittemore makes no criticism of the method of analysis of the plaintiff's experience upon which the defendant based its findings, with the exception of two classes of plant, Central Office Equipment, and Buildings. These two classes of plant consist of comparatively few large units, each of which is composed of many smaller units of equipment of various ages. A Central Office or Building starts with a comparatively large initial installation which is then added to and subtracted from at intervals during its life, until eventually the central office or building becomes obsolete, inadequate, or otherwise unfit for further use, whereupon the entire unit is retired. The investments in a building or central office which were made near the time of its retirement, obviously have a shorter life than the original investment. Whittemore argues that piece-meal retirements during the life of a building or unit of central office equipment are comparatively small in relation to the total investment in that unit. This is not strictly true, as disclosed by plaintiff's records. In the case of continuous structures in the telephone plant, such as pole lines and aerial and underground cable, an initial investment consisting of a large number of units placed at a given

time is gradually reduced by the retirement of varying numbers of units at various ages. Some of the units are retired at an age much less than the average life for the group as a whole, while other units are retired at ages exceeding the group average. In order to determine the average life of a class of plant from the plaintiff's records of plant placed and retired, it is necessary to consider the distribution of retirements about the average life for the class of plant as a whole. This statement is true for Central Office Equipment and Buildings, as well as for the continuous structures in the telephone plant and is obvious from the following consideration: The resulting distributions of the ages at retirement of the dollars invested in a given class of telephone plant will be similar regardless of whether the investment is distributed over a period of *of* years and then retired all at the same time (case of Central Office Equipment and Buildings), or whether an initial investment made all at the same time is retired in varying amounts over a period of years. This proposition is illustrated in Exhibit No. IV, attached hereto and made a part hereof. In both cases, in a growing plant such as that in New Jersey, the retirements so far made contain a larger proportion of short-lived elements and a smaller proportion of long-lived elements than does the plant now in service. For this reason the average life of the plant retired is substantially less than the average life of the plant now in service. Exhibit V, attached hereto and made a part hereof, presents a more elaborate illustration involving a number of assumed Central Offices with initial installations and subsequent ad-[fol. 208] ditions proportional to those found in the plaintiff's plant. The resulting distribution of retirements by age is shown, and the proportion of long-lived and short-lived elements present at various ages can be seen. Whittemore's argument (affidavit, pp. 99 to 101), is concerned largely with a statement of the average life of the investment in Central Offices already retired, or about to be retired, as set forth in Exhibit No. 1 (affidavit, p. 107), and with the average age of the investment in existing Central Offices (Exhibit No. 2, affidavit, p. 108). Obviously the average age of the investment in Central Office Equipment at the present time must be very much less than its average life, since in a rapidly growing plant the larger part of the Central Office Equipment installed has little more than started its life in service. The importance of this fact is emphasized by consideration of the small number of retirements of Central Office Equipment which plaintiff is able to foresee at the present time. In Exhibit P. 28, in case before defendant on Structural Value, page 20, are listed the central offices retirement of which are foreseen by Whittemore. The investment in such central offices amounts to only about 8 per cent. of the total investment in Central Office Equipment. In spite of the fact that plaintiff can foresee so few retirements of Central Office Equipment, plaintiff's Depreciation Reserve associated with that class of plant as of December 31, 1923, amounted to over 33 per cent. of the book cost or actual cost to plaintiff of said Central Office Equipment. This would be a proper depreciation reserve only if approximately 40 per cent. of the life of all Central Office Equipment had expired.

In the case of buildings the application of the method of determining the average life, which is criticized by Whittemore for Central Office Equipment, produces an average life which is substantially shorter than that used by the plaintiff. No explanation has been given by Whittemore as to why a method which he claims gives too long a life for Central Office Equipment should give too short a life when applied to buildings, there being no fundamental difference in the way in which the investment in these two classes of plant is built up and retired or in the relation of piece-meal retirements to retirements of complete units in the past.

Depreciation Reserve

Whittemore states (affidavit, p. 104) that "Second, the alleged 'excess' in reserves claimed by said Board is predicated upon and is merely the result of extending into previous years the annual depreciation rates prescribed by said Board for 1925 and succeeding years." This statement is entirely incorrect in that the Normal Depreciation Reserve used by the defendant is a measure of the requirements of plaintiff in the future. Such normal reserve is related to the present rate of depreciation of plaintiff's property in New Jersey, and is not concerned with the plant retired in past years when requirements for depreciation may have differed from those at present.

Refusal of Plaintiff to Afford Access to its Records

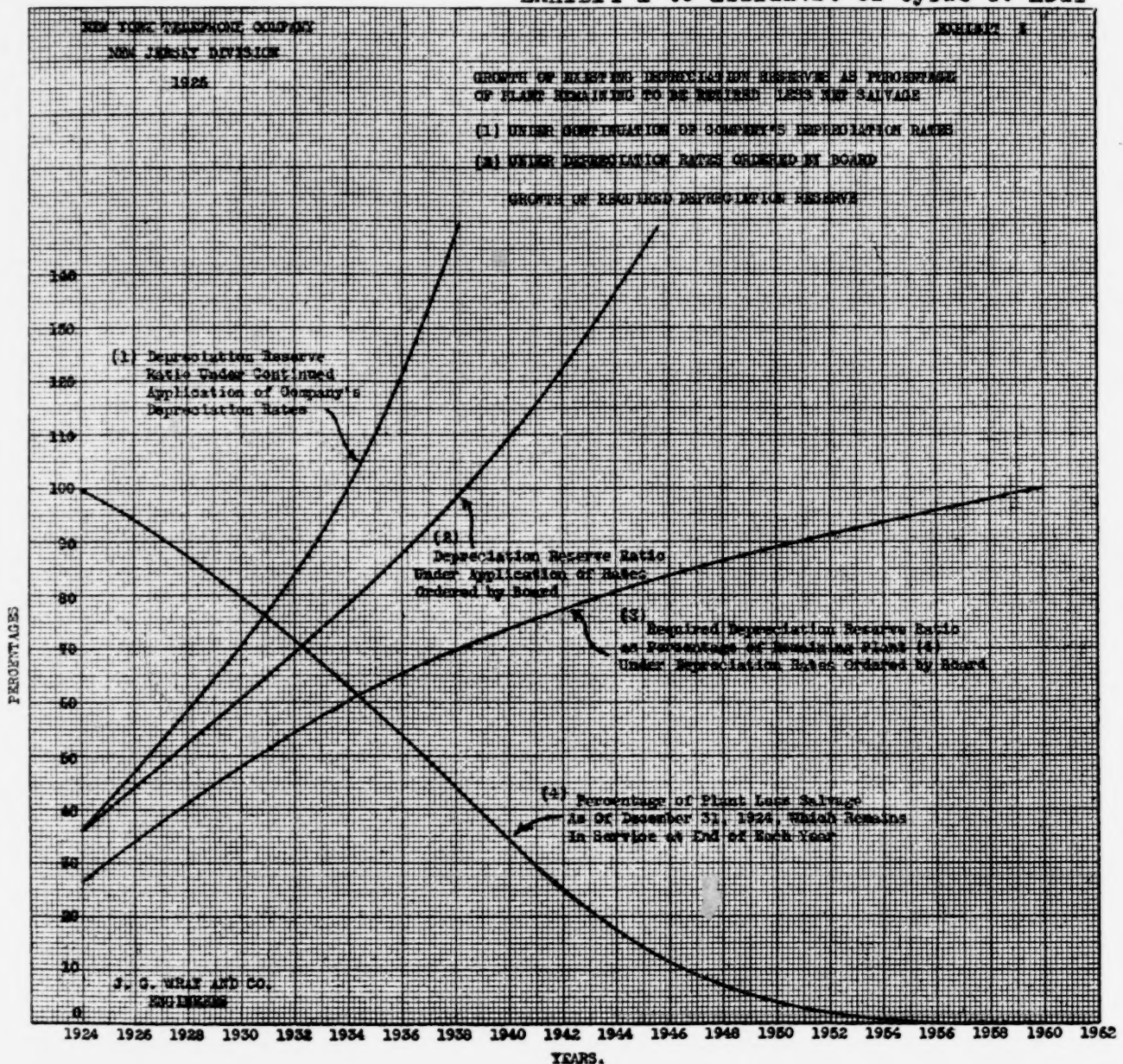
On or about February 18th I requested plaintiff, through its counsel [fol. 209] set, to furnish information respecting the retirement unit costs heretofore used by plaintiff in valuing its property when retired, and my request for such information or for access to the plaintiff's records showing said retirement unit costs was denied.

Cyrus G. Hill.

Sworn to and subscribed before me this 11th day of March, 1924. Helen D. Woodruff, Notary Public of New Jersey.
(Seal.)

(Here follow Exhibits I, II, and III, marked side folio pages 209½, 210, and 210½)

EXHIBIT 1 to affidavit of Cyrus G. Hill



GROWTH OF DEPRECIATION RESERVES FOR THE RETIREMENT OF
PLANT IN SERVICE DEC. 31, 1924.

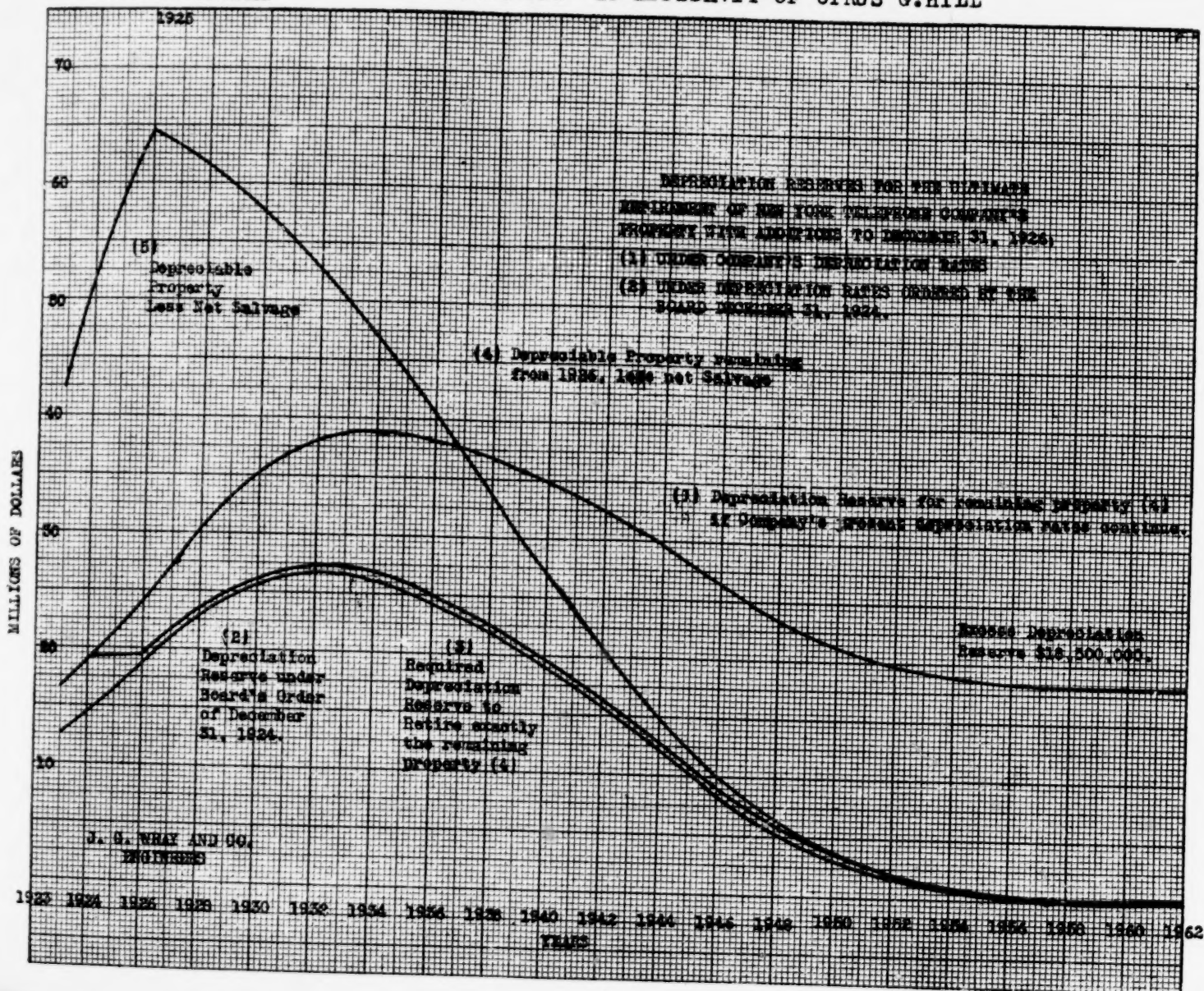
- (1) PLANT REMAINING TO BE RETIRED LESS NET SALVAGE
- (2) COMPANY'S DEPRECIATION RESERVE, CO'S DEPR. RATES CONTINUED
- (3) REQUIRED DEPRECIATION RESERVE, DEPR. RATES PER BOARD'S ORDER

	YRS	51,	52-60 PLANT, LESS NET SALVAGE	DEPR. RATES PER BOARD'S ORDER
(1)	COMPANY'S DEPR. RES.	\$51,281,000.		
(2)	REQUIRED DEPR. RES.	\$19,200,000		JAN 1924
(3)	LESS THAN \$2,000,000			
(1)	PLANT REMAINING FROM 1924, LESS SALVAGE			
(2)	COMPANY'S DEPRECIATION RESERVE	\$51,700,000		
(3)	REQUIRED DEPR. RES.	\$20,000,000		YEAR 1933
(1)	PLANT	\$10,400,000		
(2)	CO'S DEPRECIATION RESERVE	\$25,200,000		YEAR 1943
(3)	REQUIRED DEPR. RES.	\$4,800,000		
(1)	PLANT			
(2)	LESS THAN \$2,000,000			
(3)	REQUIRED RESERVE			YEAR 1963
(1)	PLANT			
(2)	CO'S DEPR. RESERVE	\$16,000,000		YEAR 1963
(3)	REQUIRED RESERVE			
(1)	NEGLIGIBLE AMOUNT			
(2)	CO'S DEPR. RESERVE	\$16,000,000		
(3)	NEGLIGIBLE AMOUNT			

J. O. WRAY & CO.
ENGINEERS

MILLIONS OF DOLLARS

EXHIBIT III TO AFFIDAVIT OF CYRUS G. HILL



[fol. 211]

EXHIBIT IV TO AFFIDAVIT OF CYRUS G. HULL

Example Showing the Equivalence, as Regards Distribution of Retirements and Average Life, of Cases (1) and (2)

Case (1), Plant placed in year 0 and retired during years 1 to 8. Case (2), Plant placed during years 1 to 8 and retired in year 9.

Case I—Applies to pole lines, cables, station apparatus, etc.				Case II—Applies to buildings and central office equip- ment			
Year	Plant placed	Plant retired	Age when retired	Plant in serv- ice end of yr.	*Plant placed	Plant retired	Plant in serv- ice end of yr.
0.....	\$100	\$		\$100	\$	\$...	\$
1.....	1	1	99	1	....	8 1
2.....	6	2	93	6	....	7 7
3.....	16	3	77	16	....	6 23
4.....	27	4	50	27	....	5 50
5.....	27	5	23	27	....	4 77
6.....	16	6	7	16	....	3 93
7.....	6	7	1	1	....	2 99
8.....	1	8	0	1	....	1 100
9.....	100	0
Average life 3.5 years				Average life 3.5 years			

*This does not accord strictly with the way Central Office Equipment or Building Plant is placed. See Exhibit V.

EXHIBIT V TO AFFIDAVIT OF CYRUS G. HILL

Example Showing Distribution of Retirements Obtained from Several Central Offices Retired at Different Ages

The rates of growth of the investment in the Central Offices are composites of 8 New York Telephone Co. Central Offices in New York City. To avoid cumbersome figures the lengths of life have been reduced in this example to about $\frac{1}{3}$ of those actually found.

Central office Total life of central office Yrs. of age	(1) A 5 yrs. Addition to investment	(2) B 7 yrs. Addition to investment	(3) C 10 yrs. Addition to investment	(4) D 14 yrs. Addition to investment	(5) Accumulated investment (1) Remaining at each age	(6) Retired at each age	(7) Plant retired as % of plant remaining	(8) Plant remaining as % of orig. investment	(9) Plant retired as % of orig. investment
1.....	28.0	14.0	14.0	4.5	400.5	15.5	3.9	96.1	3.9
2.....	25.5	20.5	14.0	9.5	385.0	36.5	9.5	87.0	9.1
3.....	22.0	18.5	13.0	10.0	348.5	48.5	13.9	74.9	12.1
4.....	17.0	17.5	12.5	10.5	300	58.5	19.5	60.3	14.6
5.....	8.0	14.5	11.5	9.5	241.5	64.0	26.5	44.3	16.0
6.....	.....	10.5	10.5	9.5	177.5	39.5	22.3	34.4	9.9
7.....	.....	4.5	9.5	8.5	138.0	35.0	25.4	25.7	8.7
8.....	.....	.....	7.5	8.5	103.0	21.5	20.9	20.3	5.4
9.....	.....	.....	5.5	7.5	81.5	23.5	28.8	14.5	5.8
10.....	.....	.....	2.0	7.0	58.5	23.5	40.5	8.6	5.9
11.....	.....	.....	.....	6.0	34.5	10.5	30.4	6.0	2.6
12.....	.....	.....	.....	4.5	24.0	10.0	41.7	3.5	3.5
13.....	.....	.....	.....	3.5	14.0	9.5	67.9	1.1	2.4
14.....	.....	.....	.....	1.0	4.5	4.5	100.0	0	1.1
Total Investment	100.0	100.0	100.0	100.0				476.7	100.0
Year retired	5	7	10	14.0					

Col. (8) shows plant surviving each year of age.

These distributions of retirement of C. O. E. are in nature similar to those obtained for retirements of thousands of poles or thousands of feet of cable. Similar methods of analysis for determining average life are, therefore, applicable to Central Office Equipment and to poles and cable.

The average rate of depreciation of telephone plant now in service is to be determined. What may be the rate of depreciation of future investments in telephone plant is not material to the present depreciation rate.

The average life of the investment of 100 units in Central Office C, Col. (3), above, at the time of its retirement in the 10th year is 5.5 years. At the end of the 5th year the investment of 65 units will have an average life of 7.1 years.

[fol. 212] IN UNITED STATES DISTRICT COURT

[Title omitted]

AFFIDAVIT OF JAMES G. WRAY—Filed March 16, 1925

STATE OF NEW JERSEY,
County of Essex, ss:

James G. Wray, being duly sworn, on his oath deposes and says:

I am the James G. Wray who made the affidavit verified March 13, 1925, in reply to the affidavit of Henry C. Carpenter in this cause.

I have carefully read the affidavit in this cause of Cyrus G. Hill, my partner, relating to depreciation. Mr. Hill's study of annual and accrued depreciation of the plaintiff's property in New Jersey was made under my general direction, and at all times I was familiar with his work. I fully concur in the statements made by him, and in his conclusions as set forth in his affidavit.

(Sgd.) James G. Wray.

Sworn to and subscribed before me this 13th day of March, 1925. Helen D. Woodruff, Notary Public of New Jersey.
(Seal.)

[fol. 213] IN UNITED STATES DISTRICT COURT

[Title omitted]

AFFIDAVIT OF JAMES G. WRAY—Filed March 16, 1925

STATE OF NEW JERSEY,
County of Essex, ss:

James G. Wray, being duly sworn, deposes and says:

I am a Consulting Engineer, a member of the firm of J. G. Wray and Company, First National Bank Building, Chicago, Illinois, and reside at No. 618 Washington avenue, Wilmette, Illinois. (The firm of J. G. Wray and Company does a general Engineering and Construction business and specializes on Telephone Engineering, Construction, Operation, Valuation and Rate problems.) I am a graduate of the University of Wisconsin, in Electrical Engineering, with the class of 1893.

In 1893 I entered the employ of the Chicago Telephone Company, advancing through the various operating departments to the position of Chief Engineer, which position I held from 1902 until my resignation in 1916. On the formation of the Central Group of Bell Telephone Companies in 1911, I was appointed Chief Engineer of this Group, which comprised the Chicago Telephone Company, the Wisconsin Telephone Company, the Michigan State Telephone Com-

pany, the Cleveland Telephone Company and the Central Union Telephone Company. I served as Chief Engineer of the Central Group of Bell Telephone Companies until my resignation in 1916. I also served as Chief Engineer for the Receivers of the Central Union Telephone Company, for a period of about 1 year, beginning in 1914.

Since my resignation in 1916 I have been employed either directly or through the firm of J. G. Wray and Company, by the United States Government, and by various State and City Governments, by Foreign Governments and by both Bell and Independent Telephone Companies. I was employed by the Bureau of Standards of Washington, D. C., in an investigation of the telephone rates of the Chesapeake & Potomac Telephone Company in Washington, D. C., and assisted the Bureau in the preparation of bulletins on telephone standards; by the Government of Alberta, Canada, in a valuation and study of rates of the telephone properties throughout the Province of Alberta; by the Government of the Province of Manitoba, Canada, on an investigation of telephone service in Winnipeg; by the Public Service Commission, and the Attorney General in the [fol. 214] State-wide investigation of telephone rates in New York state completed in the latter part of 1922; by the Corporation Counsel of the City of New York in the investigation of rates in New York City during the same period; by the Attorney General of Mississippi in a State-wide investigation of telephone rates; by the City of Chicago in an investigation of telephone rates by the Federal Court; by the Attorney General of the State of Washington and by the Cities of Seattle, Spokane and Tacoma in a State-wide investigation of telephone rates in the Federal Court; by the Corporation Counsels of Buffalo and Syracuse, New York, in telephone rate investigations before the Public Service Commission; by the Northwestern Bell Telephone Company and the Tri-State Telephone and Telegraph Company (an Independent Telephone Company), on valuations and rate cases before the Public Service Commission of Minnesota; by the Northwestern Bell Telephone Company in a Federal Court case involving telephone rates in Nebraska; by the Southwestern Bell Telephone Company in Federal Court case involving rates in Fort Smith, Arkansas; by the Indiana Bell Telephone Company in the Federal Court involving telephone rates throughout Indiana, and in previous investigations before the Public Service Commission; by The Home Telephone and Telegraph Company of Fort Wayne, Indiana, on valuations and rate investigations, both before the Public Service Commission and the Federal Court; by the Southwestern Bell Telephone Company and the Kinloch Telephone Company (an Independent Telephone Company) on a study of the economics of a proposed merger of the properties of these two Companies in St. Louis, Missouri; by the Western Electric Telephone System of Iowa; the North Dakota Independent Telephone Company of North Dakota; the Rochester Telephone Company of Minnesota, and a number of other smaller Independent Telephone Companies involving valuations and rate investigations.

I have recently completed an investigation of telephone rates for the City of Los Angeles, and testified before the California Railroad Commission.

I am at present engaged by the City of New York on the telephone rate cases of the New York Telephone Company now pending in the Federal Court, and before the Public Service Commission; and by the Attorney General of the State of Washington, and the Corporation Counsels of the Cities of Seattle, Spokane and Tacoma, on a State-wide valuation and investigation of the Pacific Telephone and Telegraph Company, and a similar investigation of values and rates of the Home Telephone and Telegraph Company of Spokane, Washington, both before the Federal Court.

During the past year I have been engaged by the Board of Public Utility Commissioners of the State of New Jersey, to investigate and testify on valuations, revenues, expenses and telephone rates of the Delaware and Atlantic Telegraph and Telephone Company, operating throughout the Southern portion of New Jersey, and of the New York Telephone Company, operating throughout the Northern portion of New Jersey.

I am familiar with the proceeding before the Board of Public [fol. 215] Utility Commissioners of New Jersey, and with the Decision and Order of the Board, a copy of which is annexed to the bill in this cause. I have carefully read the Bill of Complaint and the affidavits of plaintiff on application for interlocutory injunction.

The affidavit of Henry C. Carpenter, verified January 29, 1925 (p. 12, affidavits), incorrectly states the way in which new capital and facilities to take care of growth, are provided for. A telephone and the wiring at the subscriber's premises are added to the system for each new subscriber, but this is not true of the "copper circuit running from the place where the telephone station is located to the central office from which the telephone is served, and a separate location on the switchboard at such central office." The additional subscribers' lines and the central office facilities for such subscribers are not provided singly as needed, but are provided in large units, each of which will provide for a great many subscribers.

Carpenter's showing gross additions and net additions to the property in the entire system, and in the State of New Jersey (pp. 36 and 37, affidavits), for the years 1922, 1923 and 1924, and estimated for the years 1925 and 1926, fail to show that a large proportion of the cost of such additions each year is paid for out of accumulations in the depreciation reserve collected from the telephone subscribers. The dollars required for net additions to property each year are not the measure of new capital required. The following tables show for the respective years the very substantial amounts contributed by the rate payers, through charges for depreciation, used by plaintiff in enlarging its property as found from the Company's records, except as otherwise indicated.

Depreciation Charges, New Jersey Division

Year	Gross charge for depreciation contributed by rate payers	Used by plaintiff for depreciation	Used by plaintiff in enlarging property
1922.....	\$2,908,658	\$746,609	\$2,162,049
1923.....	3,125,199	971,080	2,154,119
1924.....	3,762,612	1,501,517	2,261,095

Net Additions to Property, New Jersey Division

Year	Net additions Carpenter affidavit	Contributed by rate payers through depreciation reserve	Contributed by plaintiff
1922.....	\$7,930,306	\$2,162,049	\$5,768,257
1923.....	8,140,035	2,154,119	5,985,916
1924.....	13,107,745	2,261,095	10,846,650

Carpenter (p. 39, affidavits) estimates the "average cost of property of plaintiff which will be used or useful in and devoted solely to the rendition of its Intrastate telephone service in the State of New Jersey, including necessary working cash during the year 1925," to be \$69,285,295.62. The plaintiff's books and accounts do not show separately the property "devoted solely to the rendition of its Intrastate telephone service," and Mr. Carpenter's figures are estimates only.

The allocations and apportionments involved in making such estimates are extremely intricate and complicated. The methods and bases of apportionment used by plaintiff are shown in neither Carpenter's affidavit, nor the other affidavits of plaintiff on application for interlocutory injunction, with particularity and detail such that [fol. 216] their reasonableness can be ascertained, without recourse to the computations made by these affiants, and the plaintiff's underlying records used in such computations. I have requested counsel for plaintiff to furnish the data actually used in the segregation of intrastate telephone service, and permit me to examine the computations showing such segregation of property, revenues and expenses, but this request has been denied.

For the foregoing reasons I am unable to compute the revenues and expenses attributable to the rendition of the intrastate telephone service of plaintiff in the State of New Jersey, or to compute the net telephone earnings arising therefrom, or to estimate either the cost or value of the property used and useful in said service.

I am familiar with the business and property of the plaintiff as a whole in New Jersey, and from a consideration of the records of investment, revenues and expenses as shown by its books, and the estimates made by the plaintiff of property additions to be made by plaintiff, I am of the opinion that the average book cost of its property in 1925, including Interest During Construction and Working Capital, and excluding Construction Work in Progress, will be \$86,400,000.

The plaintiff's net earnings on such average investment, if the de-

$$\begin{array}{r}
 2760.723 \\
 2371.812 \\
 \hline
 328.911
 \end{array}
 \begin{array}{r}
 1.012.3 \\
 328.91 \\
 \hline
 683.4
 \end{array}$$

defendant's order is complied with, will in 1925 amount to 7.71 per cent. on the book cost and 7.53 per cent. on the fair and reasonable value as found by defendant. If a 6 per cent. return be allowed on the value of the plaintiff's property, under the present telephone rates, and in compliance with the defendant's order, there will be credits to the depreciation reserve in 1925 of \$2,163,471.

The following table sets forth in detail the estimated revenues, expenses and the cost and value of the plaintiff's property in 1925 based upon defendant's findings and shows the estimated net earnings under the various bases aforesaid referred to:

Estimated Rate of Return During Year 1925 under Present Rate Schedule			
	Plaintiff's depreciation rate	Board's depreciation rate	Compliance with order of board
Telephone Revenues:			
Exchange Service.....	\$13,281,000	\$13,281,000	\$13,281,000
Toll Service.....	11,113,000	11,113,000	11,113,000
Miscellaneous	316,269	316,269	316,269
Total Telephone Revenues	\$24,710,269	\$24,710,269	\$24,710,269
Telephone Expense:			
Current Maintenance.....	\$3,453,400	\$3,453,400	\$3,453,400
Depreciation and Amortization	4,128,000	3,314,716	*683,430
Traffic	6,404,465	6,404,465	6,404,465
Commercial	2,657,000	2,657,000	2,657,000
General and Miscellaneous.	589,166	589,166	589,166
Uncollectibles	140,000	140,000	140,000
Taxes	2,269,691	2,371,812	2,700,723
Rent Expense and Deductions	325,744	325,744	325,744
Miscellaneous Deductions..	56,813	56,813	56,813
License contract Expense..	1,041,695	1,041,695	1,041,695
Total Telephone Expense	\$21,065,974	\$20,354,811	\$18,052,436
Net Telephone Earnings	\$3,644,295	\$4,355,438	\$6,657,833
Average Cost, \$86,401,736			
% Return on Avg. Cost...	4.22	5.04	7.71
Defendant's			
Average Fair and Reasonable Value..\$88,417,448			
% Return on Value.....	4.12	4.93	7.53
[fol. 217]			
(Sgd.) James G. Wray.			

*Allowing a return of 6% on value of property depreciation and amortization expense will be \$2,163,471.

Sworn and subscribed to before me this 13th day of March 1925. Helen D. Woodruff, Notary Public of N. J. (Seal)

IN UNITED STATES DISTRICT COURT

[Title omitted]

AFFIDAVIT OF JAMES G. WRAY, ON VALUE OF PROPERTY—Filed March 16, 1925

STATE OF NEW JERSEY,
County of Essex, ss:

James G. Wray, being duly sworn, deposes and says:

I am the James G. Wray who made affidavit verified March 14, 1925, in reply to affidavit of Henry C. Carpenter in this case. I have carefully read the affidavit of George W. Whittemore on value of property, verified January 29, 1925. Whittemore (Affidavit p. 19) claims a reproduction cost as of December 31, 1923, of \$63,000,000 of the "property used or useful in and devoted exclusively by the plaintiff to the rendition of its intrastate telephone service in [fol. 218] the State of New Jersey." In arriving at this valuation Whittemore states, "My estimate of Reproduction Cost New was made by using the actual quantities of units of property making up the plant and system of plaintiff in the State of New Jersey, used or useful and devoted exclusively to the rendition of intrastate telephone service as of December 31, 1923, and applying thereto the prices of materials and labor current as of that time." This language implies that the plaintiff has or is able to make an inventory of plant items "devoted exclusively" to intrastate service. This is not the fact, as a very large proportion, probably 90 per cent. of its total property is used indiscriminately for both intrastate and interstate business, and numerous computations, allocations and apportionments of the various classes of property, the revenues and the numerous expense accounts are required in making a proper segregation between these two classes of service. Such computations and apportionments have been made by Mr. Whittemore for the various classes of property.

Whittemore also states that to this reproduction cost as of December 31, 1923, of property "devoted exclusively" to intrastate business, amounting to \$63,000,000; "first, I added to the reproduction cost as of December 31, 1923, the gross additions to the property between January 1, 1924, and July 1, 1924, as taken from the books at actual cost." The plaintiff's books show the gross additions to the entire property in New Jersey, and do not show the additions to the property "devoted exclusively" to intrastate business. Whittemore could not have obtained his figures directly from the books, but must have made numerous allocations and apportionments in order to arrive at the cost of gross additions of property devoted solely to the Intrastate business.

Whittemore also says "second, I subtracted the plant which had been retired from service during that period, valued at the same amounts at which I had previously included them in my estimate." The entire plant retired from service during the period, devoted to both Interstate and Intrastate business is shown on the books, and the Intrastate plant as such is not shown. Whittemore could have arrived at his figures only by making numerous allocations and apportionments.

The same comment applies to Whittemore's procedure as shown under "Third" and "Fourth."

Whittemore's affidavit carries the implication that the plaintiff's records show the amount of working cash capital and materials devoted by it to the rendition of its Intrastate telephone service in the State of New Jersey. The plaintiff's records do not show the amounts of either working cash or materials and supplies devoted by it solely to rendering its Intrastate telephone service. The figures submitted by Whittemore are estimates.

Whittemore alleges that the depreciation of plaintiff's Intrastate property amounts to \$9,075,000. His affidavit implies that he has inspected the Intrastate property and finds depreciation actually existing in such amount. Whittemore could not have inspected the plaintiff's Intrastate property, as such, for the reason that no record exists showing what items of property should be classed as Intrastate property. His figures could only have been arrived at through [fol. 219] numerous allocations and apportionments, as heretofore described.

Whittemore estimates the going value of the property of the plaintiff devoted to the rendition of its Intrastate telephone service to be \$9,010,000. This figure could only have been obtained as the result of allocations and apportionments such as were made in estimating the value of the physical property devoted to rendering the Intrastate telephone business of the plaintiff.

Whittemore's estimates of the present fair and reasonable value of the plaintiff's property as of July 1, 1924, devoted to rendering its Intrastate telephone service are the total combined figures resulting from the aforesaid allocations and apportionments made by him.

In its testimony before the defendant at hearings which resulted in the order by the defendant complained of in this suit, the plaintiff failed to present any testimony whatever as to the cost or value of its property devoted to rendering its Intrastate telephone service, or as to the revenues produced by such service, or the expenses incurred in furnishing it; nor were any facts relating to its Intrastate telephone business as distinguished from its aggregate business brought to the attention of the engineers for the defendant.

A segregation such as made by Whittemore of the Intrastate property requires the compilation of a very large amount of data, and involves numerous and intricate computations. To compile the data from the original records of plant and make the computations for such a segregation will require many months.

Counsel for plaintiff has refused to furnish me the data compiled

and the computations made by plaintiff in making such segregation, and I am unable in the time available to compile from the plaintiff's underlying records the vast amount of data and make the computations necessary for an independent segregation, and estimate either the cost or value of the property devoted to the Interstate business or the revenues and expenses of such service; nor check Whittemore's claimed results or the propriety of the methods used.

Assisted by members of the staff of J. G. Wray and Company, I have made a thorough investigation of the plaintiff's entire property used and useful in New Jersey, have checked the inventory made by Whittemore, have inspected the plant to ascertain its physical condition, have carefully studied the plaintiff's recent actual construction costs incurred in making additions to its property, and have estimated the cost of reproducing such property at prices as of July 1, 1924, which are summarized as follows:

Reproduction Cost of Plant and equipment (including Construction in Progress and not in service)	\$86,049,535
Reproduction Cost New of Plant and equipment (in service)	83,686,057
Observed deterioration and manifested inadequacy	11,358,538
Reproduction Cost New of plant and equipment, less observed deterioration and manifested inadequacy (in service)	72,327,519
Working Capital	1,769,050
Going Value (Fixed by Board)	3,600,000

I have estimated the reproduction cost of the plaintiff's entire property used and useful, as of December 31, 1924, taking into account the gross additions and the retirements of property from June 30, 1924, to and including December 31, 1924, and find it to be \$95,000,000.

[fol. 220] The defendant found the value of the plaintiff's property to be \$73,370,000 as of July 1, 1924. If to this amount be added the book additions made to said property between June 30, 1924, and December 31, 1924, the result produced is \$82,000,000. If to said figures the further net book additions estimated by plaintiff to be installed in 1925 be taken into account the defendant's average value for 1925 would be \$88,000,000.

(Sgd.) James G. Wray.

Sworn and subscribed to before me this 13th day of March, 1925. Helen D. Woodruff, Notary Public of N. J. (Seal.)

IN UNITED STATES DISTRICT COURT

[Title omitted]

AFFIDAVIT OF JAMES G. WRAY ON REVENUES, EXPENSES, AND NET EARNINGS—Filed March 16, 1925

STATE OF NEW JERSEY,
County of Essex, ss:

I am the James G. Wray who made affidavit verified March 13, 1925, in reply to affidavit of Henry C. Carpenter in this case. I have carefully read the affidavit of Harland A. Trax of the affidavits of plaintiff on application for an interlocutory injunction verified January 29, 1925, and am familiar with the statements made therein. For the reasons stated in my affidavit in reply to Carpenter, I am unable to estimate either the cost of property, revenues or the expenses attributable to the Intrastate telephone service of plaintiff in the State of New Jersey for the years 1922, 1923, 1924 and 1925, as set forth in the affidavit of said Trax on pages 29-38 of the affidavits.

[fol. 221] I am, however, familiar with the cost and reproduction cost, plaintiff's claims of value and defendant's findings of value, the revenues and the expenses relating to the entire property and business of plaintiff in the State of New Jersey and say that the revenues, expenses and net earnings for the years 1922, 1923, 1924 and 1925 in dollars and as per cents of the cost of said property during those periods and also as per cents of the value of said property as found by the defendant in the order complained of (with changes in adjustments for the property since said years), using the depreciation rates specified but without further adjustment of depreciation expense as required by said order would have been as shown in the following tables:

Income Statement New York Telephone Co., New Jersey Division,
on Basis of Present Rates

Telephone Revenues:	1922
Exchange Service	\$9,085,118
Toll Service	8,553,760
Miscellaneous Revenues	232,257
Total Telephone Revenues	<u>\$17,871,135</u>
Telephone Expenses:	
Current Maintenance	\$2,388,224
Depreciation and Amortization	2,035,405
Traffic	4,376,531
Commercial	1,840,820
General and Miscellaneous	442,532

Telephone Expenses:

1922

Uncollectibles	59,824
Taxes	1,860,568
Rent Expense and Deductions	232,089
Miscellaneous Deductions	65,706
License Contract Expense	753,226
Total Telephone Expense	<u>\$14,054,925</u>
Net Telephone Earnings	<u>\$3,816,210</u>
Average Cost	\$54,128.721
% Return on Average Cost	7.05
Defendant's Average Fair and Reasonable Value.....	\$56,229.232
% Return in Value	6.79

Income Statement New York Telephone Co., New Jersey Division,
on Basis of Present Rates

Telephone Revenues:

1923

Exchange Service	\$10,648,241
Toll Service	9,322,275
Miscellaneous Revenues	254,824
Total Telephone Revenues	<u>\$20,225,340</u>

Telephone Expense:

Current Maintenance	\$2,735,508
Depreciation and Amortization	2,363,312
Traffic	4,989,281
Commercial	2,055,629
General and Miscellaneous	529,298
Uncollectibles	83,468
Taxes	2,171,137
Rent Expense and Deductions	255,438
Miscellaneous Deductions	61,980
License Contract Expense	851,332

Total Telephone Expense \$16,096,383Net Telephone Earnings \$4,128,957

Average Cost	\$62,621.427
% Return on Average Cost	6.59
Defendant's Average Fair and Reasonable Value.....	\$64,759.528
% Return on Value	6.38

[fol. 222] Income Statement New York Telephone Co., New Jersey
Division, on Basis of Present Rates

Telephone Revenues:		1924
Exchange Service	\$12,003,458	
Toll Service	10,324,528	
Miscellaneous Revenues	273,294	
Total Telephone Revenues	<u>\$22,601,280</u>	

Telephone Expense:		
Current Maintenance	\$3,419,260	
Depreciation and Amortization	2,820,788	
Traffic	5,802,614	
Commercial	2,421,137	
General and Miscellaneous	591,095	
Uncollectibles	143,337	
Taxes	2,116,432	
Rent Expense and Deductions	293,148	
Miscellaneous Deductions	65,858	
License Contract Expense	951,042	
Total Telephone Expense	<u>\$18,624,711</u>	

Net Telephone Earnings \$3,976,569

Average Cost	\$73,808,863
% Return on Average Cost	5.39
Defendant's Average Fair and Reasonable Value	\$76,370,000
% Return on Value	5.21

Income Statement New York Telephone Co., New Jersey Division,
on Basis of Present Rates

Telephone Revenues:		
Exchange Service	\$13,281,000	
Toll Service	11,113,000	
Miscellaneous Revenues	316,269	
Total Telephone Revenues	<u>\$24,710,269</u>	

Telephone Expense:		
Current Maintenance	\$3,453,400	
Depreciation and Amortization	3,314,716	
Traffic	6,404,465	
Commercial	2,657,000	
General and Miscellaneous	589,166	
Uncollectibles	140,000	

Telephone Expenses:

Taxes	2,371,812
Rent Expense and Deductions	325,744
Miscellaneous Deductions	56,813
License Contract Expense	1,041,695
Total Telephone Expense	<u>\$20,354,811</u>
Net Telephone Earnings	<u>\$4,355,438</u>
Average Cost	\$86,401.736
% Return on Average Cost	5.04
Defendant's Average Fair and Reasonable Value	\$88,417.448
% Return on Value	4.93

I have also estimated the revenues and expenses relating to the entire property and business of plaintiff and the net earnings, on the assumption that the telephone rates for exchange service filed by plaintiff and disallowed by order of defendant had been in effect in the years 1922, 1923 and 1924, and are in effect in the year 1925, and say that in dollars and as per cents of the cost of said property during those periods, and also as per cents of the value of said property as found by defendant in the order complained of (with adjustments for changes in the property since said years), using the depreciation rates specified but without further adjustment of depreciation expense as required by said order, they would have been as shown in the following tables:

Income Statement New York Telephone Co., New Jersey Division,
Basis of Rates Filed 3-6-24

Telephone Revenues:	1922
Exchange Service.....	\$11,183,780
Toll Service.....	8,553,760
Miscellaneous Revenues.....	232,257
Total Telephone Revenues.....	<u>\$19,969,797</u>
Telephone Expenses:	
Current Maintenance.....	\$2,388,224
Depreciation and Amortization.....	2,035,405
Traffic	4,376,531
Commerical	1,840,820
General and Miscellaneous	442,532
Uncollectibles	59,824
Taxes	2,122,901
Rent Expense and Deductions.....	232,089

Telephone Expenses:

1922

Miscellaneous Deductions.....	65,706
License Contract Expense.....	753,226

Total Telephone Expense..... \$14,317,258

Net Telephone Earnings..... \$5,652,539

Average Cost.....	\$54,128,721
% Return on Average Cost.....	10.44
Defendant's Average Fair and Reasonable Value.....	\$56,229,232
% Return on Value.....	10.05

Income Statement New York Telephone Co., New Jersey Division, on
Basis of Rates Filed 3-6-24

Telephone Revenues:

1923

Exchange Service.....	\$13,107,985
Toll Service.....	9,322,275
Miscellaneous Revenues.....	254,824

Total Telephone Revenues..... \$22,685,084

Telephone Expenses:

Current Maintenance.....	\$2,735,508
Depreciation and Amortization.....	2,363,312
Traffic	4,989,281
Commercial	2,055,629
General and Miscellaneous.....	529,298
Uncollectibles	83,468
Taxes	2,478,605
Rent Expense and Deductions.....	255,438
Miscellaneous Deductions.....	61,980
License Contract Expense.....	851,332

Total Telephone Expense..... \$16,403,851

Net Telephone Earnings..... \$6,281,233

Average Cost.....	\$62,621,427
% Return on Average Cost.....	10.03
Defendant's Average Fair and Reasonable Value.....	\$64,759,528
% Return on Value.....	9.70

[fol. 224] Income Statement New York Telephone Co., New Jersey
Division, on Basis of Rates Filed 3-6-24

Telephone Revenues:		1924
Exchange Service.....		\$14,776,257
Toll Service.....		10,324,528
Miscellaneous Revenues.....		273,294
Total Telephone Revenues.....		<u>\$25,374,079</u>
Telephone Expenses:		
Current Maintenance.....		\$3,419,260
Depreciation and Amortization.....		2,820,788
Traffic		5,802,614
Commercial		2,421,137
General and Miscellaneous.....		591,095
Uncollectibles		143,337
Taxes		2,588,030
Rent Expense and Deductions.....		293,148
Miscellaneous Deductions.....		65,858
License Contract Expense.....		951,042
Total Telephone Expense.....		<u>\$19,096,309</u>
Net Telephone Earnings.....		<u>\$6,277,770</u>
Average Cost.....		\$73,808.863
% Return on Average Cost.....		8.51
Defendant's Average Fair and Reasonable Value.....		\$76,370.000
% Return on Value.....		8.22

Income Statement New York Telephone Co., New Jersey Division, on
Basis of Rates Filed 3-6-24

Telephone Revenues:		1925
Exchange Service.....		\$16,348,911
Toll Service.....		11,113,000
Miscellaneous Revenues.....		316,269
Total Telephone Revenues.....		<u>\$27,778,180</u>
Telephone Expenses:		
Current Maintenance.....		\$3,453,400
Depreciation and Amortization.....		3,314,716
Traffic		6,404,465
Commercial		2,657,000
General and Miscellaneous.....		589,166

Telephone Expenses:	1925
Uncollectibles	140,000
Taxes	2,755,303
Rent Expense and Deductions.....	325,744
Miscellaneous Deductions.....	56,813
License Contract Expense.....	1,041,695
Total Telephone Expense.....	<u>\$20,738,302</u>
Net Telephone Earnings.....	<u>\$7,039,878</u>
Average Cost.....	<u>\$86,401,736</u>
% Return on Average Cost.....	8.15
Defendant's Average Fair and Reasonable Value.....	<u>\$88,417,448</u>
% Return on Value.....	7.96

(Sgd.) James G. Wray.

Sworn and subscribed to before me this 13th day of March,
1924. Helen D. Woodruff, Notary Public of New Jersey.
(Seal.)

[fol. 225] IN UNITED STATES DISTRICT COURT

[Title omitted]

AFFIDAVIT OF JAMES G. WRAY—Filed March 16, 1925

STATE OF NEW JERSEY,
County of Essex, ss:

I am the James G. Wray who made affidavit verified March 13, 1925, in reply to affidavit of Henry C. Carpenter, in this case. I have carefully read the affidavit of Andrew Sangster, relating to the method used by him in making segregation of the Intrastate property, revenues and expenses of plaintiff's business in the State of New Jersey, and am familiar with its contents. It is apparently the purpose of this affidavit by allocating and apportioning the property, revenues and expenses alleged to apply to the Interstate telephone service, to present to the Court the figures for the property, revenues and expenses which apply only to the Intrastate telephone service, as set forth in the affidavit of Harland A. Trax, beginning on page 27; by George W. Whittemore, in his affidavit on value, beginning on page 17, and by Carpenter, in affidavit beginning on page 9, of Affidavits of Plaintiff on Application for Interlocutory Injunction.

The property of the plaintiff used and useful in the service of the public, in the State of New Jersey, is used in the performance of Intrastate telephone Exchange and Toll service; Interstate telephone Toll service, and various other forms of intelligence com-

munication such as Private Line service, Telegraph and Signalling service, Radio, the transmission of pictures over wires or by radio, and other services. It leases a very large proportion of its property, amounting to many millions of dollars, to the American Telephone and Telegraph Company, which furnishes Intrastate and Interstate telephone Toll service, Telegraph Lead Wire, Radio and other services to its patrons. The property and business of plaintiff are not limited alone to Intrastate and Interstate telephone service, as is alleged by said Sangster and other affiants who have presented affidavits in this case. The property leased by the American Telephone and Telegraph Company from this plaintiff is used in furnishing the various classes of service aforesaid, involving telephone, telegraph and other communication services between its patrons within the State of New Jersey, between its patrons in the State of New Jersey and patrons outside of the State, and between its patrons outside of New Jersey who communicate by wires extending through the State of New Jersey, owned in large part by this plaintiff. This plaintiff leases to the American Telephone and [fol. 226] Telegraph Company all the wires and other facilities within the so-called "33-mile area," used by it for its Long Distance and other services originating within the territory of plaintiff, incoming to points within the territory of plaintiff, or routed through the territory of plaintiff.

From my knowledge of the plaintiff's business and property in New Jersey, it is my opinion that more than 90% of its entire property has a common use, being used indiscriminately for either Intrastate or Interstate service, less than 10% of its property is "devoted exclusively to," or "exclusively used" in either the Intrastate or the Interstate telephone service of plaintiff. In arriving at a just measure of the property and expenses attributable to either the Intrastate or Interstate telephone services, numerous complicated allocations and apportionments are necessary.

The affidavit of said Sangster fails to show in detail the particular methods used by him in apportioning the various classes of property, and the revenues and expenses. His affidavit, though purporting to show much detail, to all practical purposes, furnishes little information as to the exact bases of such segregation, or the detailed methods used by him. He states that, "The fundamental basis adopted in the making of such separation, and shown in this affidavit, is the extent of the use of the property and operating services in each of the said two classes of plaintiff's telephone service." He nowhere describes what he means by "extent of the use," whether the time in use on originating calls only, or on originating and incoming calls; whether the number of originating calls alone, or the total of originating and incoming calls; whether the number of originating revenue calls, of the number of originating and incoming calls that produce revenue; whether the "extent of use" by any one or combination of the foregoing, or other methods is applied to the busy hour, to the 24-hour day, a month or a year; whether the "extent of use" is obtained for the different classes of exchange property in each operating exchange and for each toll

line or groups of lines separately, or for the property as a whole; whether by "extent of use" of its property is meant use by the subscriber in connection with the service he receives, or the extent to which the plaintiff's operators or others may use the property; whether "extent of use" means primary use (that is, the use for which the property was planned), or major use at the present time, or proportionate use as measured by any of the foregoing classes of use. The results of segregation of Intrastate property, revenues and expenses will differ greatly, depending upon the interpretation of what is meant by "extent of the use."

The description of his method, while vague and very general in character, indicates that he may have followed the method used by him in making a segregation for the plaintiff of its Intrastate telephone business in New York State. I am familiar with the methods used by him in said segregation in New York State and know that said method was unsound and attributed to the Intrastate business more property and larger expenses than was just and reasonable, or in accord with the facts. An example of this is the treatment of the Long Distance service of the American Telephone and Telegraph Company as contrasted with the plaintiff's own Exchange and [fol. 227] Toll services. Telephone services between Exchange stations in the same local service area is classed as Exchange service. Telephone service between Exchange stations in one local service rear and Exchange stations in another local service area may be either Toll service (completed wholly over the Toll lines of plaintiff or jointly over toll lines of plaintiff and its sublicensee connecting companies), or Long Distance service completed in whole or in part over the lines of the American Telephone and Telegraph Company. The plaintiff's Exchange service is all Intrastate service, and its Toll service is both Intrastate and Interstate service. The Long Distance service of the American Telephone and Telegraph Company in New Jersey is both Intrastate and Interstate service, and includes, in addition to service originating at and service incoming to stations belonging to plaintiff, a through Long Distance service of large volume originating at and terminating at stations outside of plaintiff's territory in New Jersey. Under a contract with the American Telephone and Telegraph Company the plaintiff owns and leases to said American Company all the facilities used by it in the State of New Jersey within a radius of 33 miles of the City Hall of New York City, and including all of Monmouth County. The cost and value of such property of the plaintiff, leased to the American Company, is known to me to be many millions of dollars. The plaintiff has presented no figures in any of its affidavits, nor did it present to the Board any figures to show that it is receiving a fair and reasonable share of the revenues coming from said originating, incoming and through Long Distance telephone service over its wires.

The rates filed by plaintiff, and disallowed by the Board, were all Exchange rates. The segregation of Intrastate business made by Mr. Sangster as described in his affidavit, purports to eliminate from the total business of plaintiff in the State of New Jersey only the Interstate telephone business. His elimination, however, also includes the

Interstate Long Distance business of the American Telephone and Telegraph Company.

Mr. Sangster includes in the Intrastate business, property, revenues and expenses not only the property, revenues and expenses attributable to the Exchange service on which the defendant disallowed the increase in rates asked for by the plaintiff, but said Intrastate property, revenues and expense as segregated by said Sangster include also the property, revenues and expenses attributable to the Intrastate business of the American Telephone and Telegraph Company, and of this plaintiff and all other classes of Intrastate services heretofore referred to.

In his segregation of the property, revenues and expenses of plaintiff in New York State, Sangster classed as an Intrastate use of such facilities the use of plaintiff's Exchange property and services when used for the Interstate Long Distance service of the American Telephone and Telegraph Company. It is my opinion that Mr. Sangster adopted the same method in the segregation made by him of the plaintiff's property in New Jersey. The application of such method of segregation will charge to the Intrastate service much more property and expenses than are properly attributable to, or are used in such Intrastate service of plaintiff.

[fol. 228] The application of the methods of segregation to the property, revenues and expenses of the plaintiff has in my opinion resulted in excessive estimates of property and expenses attributable to said Intrastate business, as set forth in affidavits of George W. Whittemore and Harland A. Trax.

Lacking basic data, and for want of sufficient information as to the exact methods used by Sangster, I am unable to say to what extent the estimates of property and expenses set out in affidavits of Whittemore and Trax, are excessive.

(Sgd.) James G. Wray

Sworn and subscribed to before me this 13th day of March, 1925. Helen D. Woodruff, Notary Public of N. J. (Seal.)

IN UNITED STATES DISTRICT COURT

[Title omitted]

AFFIDAVIT OF JOHN P. PETTY—Filed March 16, 1925

STATE OF NEW JERSEY,
County Essex, ss:

John P. Petty, being duly sworn, deposes and says:

I reside at 57 James Street, in the City of Newark, State of New Jersey; I am Deputy Chief Engineer of the Bureau of Utilities of the Board of Public Utility Commissioners, having been Acting Chief Engineer from July 23, 1917, to June 1, 1919; to become eligible

for employment by said defendant Board, I took a Civil Service examination embracing civil engineering, inventory and appraisal work, and was given a qualifying mark of 86 out of 90 maximum points.

In 1881 I was graduated as a Bachelor of Arts from the University [fol. 229] of Mississippi as first honor man. I then studied mining engineering for three years at Columbia University, again leading my class.

I was Chief Engineer and General Manager of the Angostura Gold Mining Company and with two assistant engineers examined said property, designed and bought the plant to operate same. I was Chief Engineer and General Manager of the Playa de Oro Gold Mining Company and was engaged in the construction and operation of its property, employing about 500 men.

In work more closely related to valuation, I bought and sold in my own name in New York and vicinity, real estate costing from \$500,000 to \$1,000,000. I have appraised for corporation and, indirectly, for New York City real estate of a value of upwards of \$10,000,000. I have certified payments to builders for construction work in progress in Greater New York on from 50 to 100 buildings. On behalf of the New Jersey Gas Company I assisted in preparing a valuation of its property which was presented to the defendant Board. I have assisted in the preparation of appraisals of utility properties for the Board; I have examined appraisals submitted to the Board and continued appraisals to subsequent dates both by book costs and by the application of price indices translating prices from one period into that of another period. I have prepared data and reports of mergers, security and rate cases, and have been employed on a majority of the important rate cases heard by the defendant Board, including all the so-called Bell Telephone cases, since 1914.

With respect to accounting, I was Auditor of the General Agency of the Mutual Life Insurance Company of New York for the State of Ohio; was in charge of the accounting for construction and operation of the New Jersey Gas Company, made studies for the development of unit costs and for the promotion of plant efficiency. In 1916 and 1917 I made a development cost study of the property of the New York Telephone Company and its predecessor companies in the northern part of New Jersey, which study covered book and original cost of tangible and intangible property in New Jersey by years, of revenue and expenses and return on cost, beginning with the year 1882 and continued down to and including the year 1916. For the same period I made a special study of the history of the plaintiff and its predecessor companies with respect to depreciation and interest during construction. These studies were incorporated in exhibits submitted in the 1913-1917 rate case of the plaintiff in this case. I made similar cost studies, among others, with respect to the book cost and original cost of a considerable portion of the property of Public Service Electric Company, Public Service Railway Company, all of the Hackensack Water Company, and checked the preliminary estimates of the cost of the Public Service Newark Terminal, for the construction of which the approval of a security issue was

asked of this Board. In the course of these investigations I have ascertained the book cost and the original cost of probably more than 100 structures, the cost of electric generating station and other equipment, the cost of various electric transmission lines, cables, conduits and the time required for the construction thereof, the actual historical overheads as charged and a large mass of statistical matter useful [fol. 230] in appraisal work. I submitted exhibits and testimony in cases before the defendant Board and before the Special Master appointed by this Court to hear the Public Service Railway Company's application on Bill for Injunction, and was a witness on behalf of the Board at hearings in the plaintiff's application for increased rates, decision in which case is the subject matter of this application.

It has been part of my duties with the Board to keep informed as to current prices of capital and as to pertinent statistical information relating to price trends.

Wholesale Commodity Indices, 1910 to 1924, Inclusive

The Bureau of Labor Statistics of the United States Department of Labor issues monthly a series of index numbers of wholesale commodity prices. These indices have been revised from time to time, the latest revision having been published in June, 1923, with 1913 prices taken as 100, and setting forth index numbers for the year 1890 to 1922, inclusive, as shown more fully in the Bureau's Bulletin No. 335. Monthly bulletins on the same basis have been issued since 1922.

In the following table will be shown in column (2) the series of wholesale commodity index numbers with 1913 equal to 100; in column (3) the indices are computed with 1910 equal to 100; and in column (4) the indices are on the basis of 1916 equal to 100, the latter year being the date of the Board's valuation leading to a reduction in rates of the plaintiff:

Table—J. P. P-1

Year (1)	1913—100 (2)	1910—100 (3)	1916—100 (4)
1910.....	101	100	80
1911.....	93	92	73
1912.....	99	98	78
1913.....	100	99	79
1914.....	98	97	77
1915.....	101	100	80
1916.....	127	126	100
1917.....	177	175	139
1918.....	194	192	153
1919.....	206	203	162
1920.....	226	224	178
1921.....	147	145.5	116
1922.....	149	147.5	117
1923.....	154	152.5	121
1924.....	150	148.5	118

Exhibit J. A. M.—2, attached to Jesse A. Moir's affidavit, shown on pages 70 and 71 of plaintiff's affidavit, in column (c) indicates the relation between the commodity price levels of 1910 and 1913 to be 100 and 103, respectively, whereas the official figures quoted in column (2) above show the relation to be as 101 to 100 or as 100 to 99. This results in an inflation of all indices subsequent to 1913 as shown in column (c) of said Exhibit J. A. M.—2. As an instance, his index for 1919 (1910 equal to 100) is 212, whereas it should be 203 if based upon the revised commodity indices as officially revised and issued.

Comparison of Wholesale Commodity Indices for the Years 1861 to 1878, Inclusive, and for 1914 to 1924, Inclusive

I have taken the index prices for wholesale commodities for the years 1861 to 1878 from a copy of those quoted in a report of the Finance Committee of the United States Senate made in 1893, and [fol. 231] these are shown in Table J. P. P.—2, column (a) below. In column (b) these are shown with the index prices for 1861, the opening year of the Civil War, made equal to 100. In column (c) are shown for the years 1914 to 1922 the latest revised wholesale commodity prices shown on page 9 of the Bureau of Labor Statistics Bulletin No. 335. The years 1923 and 1924 are taken from the monthly bulletins and averaged for the year. In all of the latter indices 1913 is taken as 100. In column (d) the prices from column (c) are re-calculated on the basis of 1914, the opening years of the World War, being equal to 100.

The Civil War began in 1861 and the World War in 1914. History frequently repeats itself, and the experience of the past is one of the best means for predicting the future. These index prices are shown in the following table:

Table—J. P. P.-2

Year	Indices (Senate Report)		Year	Indices of U. S. Bureau of Labor Statistics	
	Base (1)	1861-100 (2)		1913-100 (3)	1914-100 (4)
1861.....	103	100	1914.....	98	100
1862.....	122	188	1915.....	101	103
1863.....	168	163	1916.....	127	129
1864.....	237	230	1917.....	177	180
1865.....	218	212	1918.....	194	198
1866.....	194	188	1919.....	206	210
1867.....	174	169	1920.....	226	230
1868.....	170	165	1921.....	147	150
1869.....	166	161	1922.....	149	152
1870.....	148	144	1923.....	154	157
1871.....	137	133	1924.....	150	153
1872.....	142	138			
1873.....	141	137			
1874.....	134	130			
1875.....	126	122			
1876.....	117	114			
1877.....	114	111			
1878.....	103	100			

A graph of the figures in columns (b) and (d) is shown as J. P. P.-3 attached to this affidavit and made part hereof.

(Here follows Graph J. P. P.-3, marked side folio page 231½)

[fol. 232]

Rate of Return

I have made an investigation of the average monthly market prices of the major issues of the New York Telephone Company's bonds covering the years 1914 to 1924, and have computed the monthly yields on such issues during this period. This showed that the average yield at the market price to the investor during this period was 5.45 per cent. In a similar manner I computed the yield on the plaintiff's 6.5 per cent preferred stock at average monthly market prices since the stock has been issued and found it to average 5.94 per cent on the market price. The New York Telephone Company's common stock is all owned by the parent company, the American Telephone & Telegraph Company, and is not quoted in the markets. I have computed the average yield on the 8 per cent common stock of the New England Telegraph & Telephone Company, at average monthly market prices, for the year 1924 and found the same to be 7.94 per cent. This company has a capital structure similar in many respects to that of the New

BOARD OF PUBLIC UTILITY COMMISSIONERS

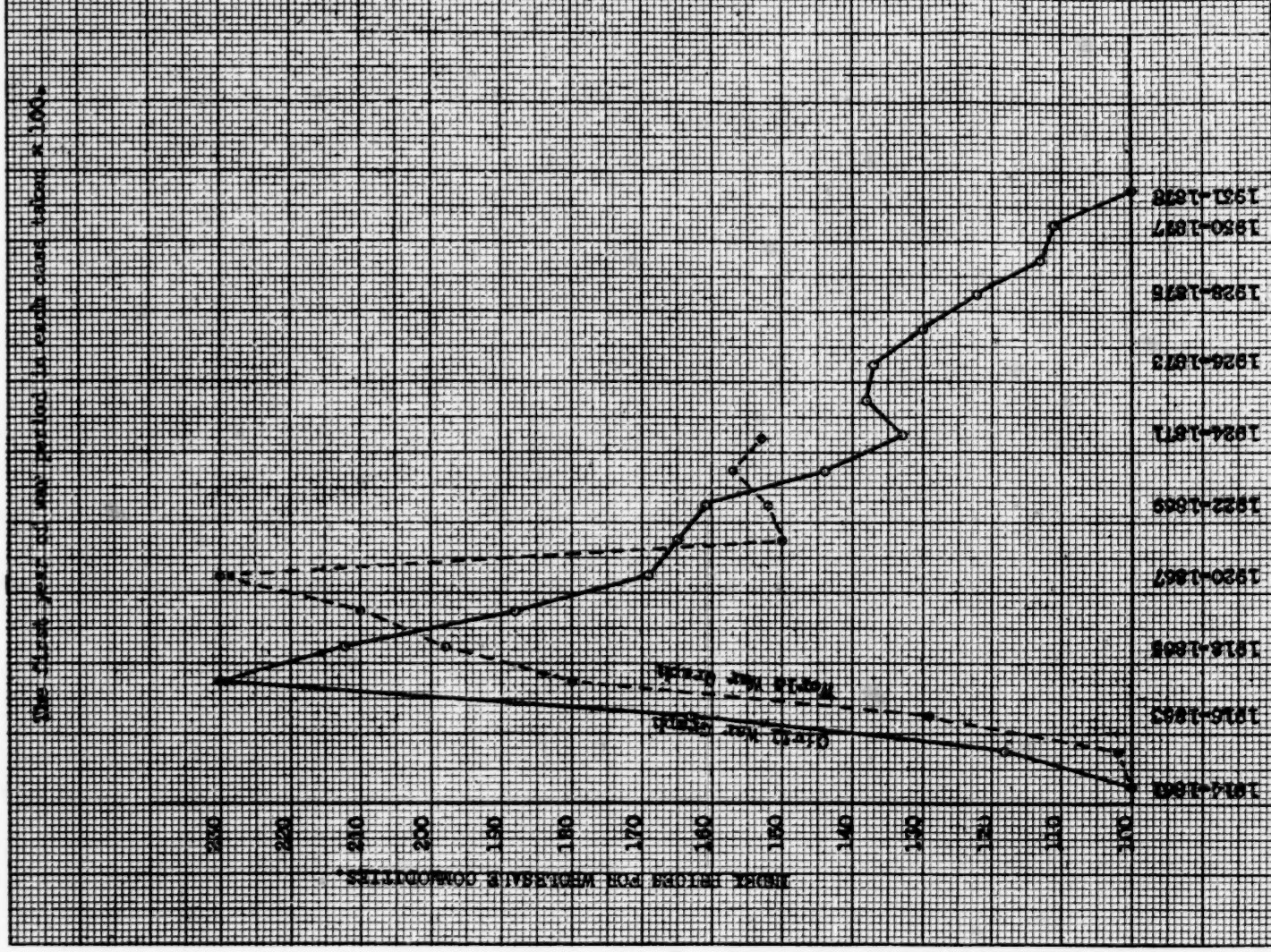
RE. NEW YORK TELEPHONE COMPANY

BILL FOR INJUNCTION

COMPARISON OF

ANNUAL AVERAGE WHOLESALE COMMODITY INDEX PRICES,

1861-1878 WITH THOSE OF 1914-1924



York Telephone Company, its net earnings, however, having been insufficient to pay the dividend on the 8 per cent stock. In taking the average yield on this stock, then, the yield at the market price would be higher to compensate for the greater risk to the investor than would be the case with the New York Telephone Company's common stock. On the other hand, the 8 per cent common stock of the Southern New England Telephone Company is selling at market prices which would yield on the average about 5.94 per cent for the year 1924. The average yield on these two 8 per cent common telephone stocks is 6.73 per cent. I have applied these yields to the corresponding classes of securities of the plaintiff and on this basis have found the composite yield on all of its securities, based on market prices derived in the manner aforesaid, to be 6.20 per cent. I have taken the cost of financing to equal 0.2 per cent, making a total of 6.4 per cent yield which would attract capital into the business of the company as of December 31, 1924. A return of 7.5 per cent would provide a surplus or cushion of 17 per cent.

Financial publications have recently contained advertisements of public offerings of electric light and power utilities' securities to yield 5 per cent and many good grade utility bonds are selling on practically the same basis of yield.

I am of the opinion that a return of approximately 7.5 per cent will attract capital into the securities of the New York Telephone Company, and that if the three mortgages of the plaintiff were consolidated into a single mortgage the cost of money would be slightly lower.

Valuation of the Plaintiff's Tangible Property (Plant and Equipment)

As of July 1st, 1916, the defendant Board fixed the value of the plant and property of the plaintiff in this case. I have segregated from the total value the value of the plant and equipment of the plaintiff in the State of New Jersey as found by the Board and added thereto by years the gross additions and have allocated retirements to the 1916 valuation and to the cost of each year's gross additions. In so doing I separated the property into groups. To the base figures so ascertained I have applied construction cost indices [fol. 233] derived from the company's own records for each group of property for each year and have thus translated the valuation so arrived at into prices as of December 31st, 1923. I continued the valuation so arrived at by the use of the company's net additions for the first six months of 1924 and made a deduction due to the reduction in central office equipment prices effective July 1st, 1924. As of that date the depreciated value of the tangible fixed capital (that is, plant and equipment in service) was found to be \$69,807,603, as more fully set forth in bill of complaint in this matter, page 41, column (4) line (e). The defendant Board fixed a value for this portion of the plaintiff's property as of the said date in the amount of \$71,000,000.

Adding to the value of \$69,807,603, above stated, \$3,600,000 for going concern value and \$1,770,000 for working capital as fixed by the Board would give a total value of \$75,177,603 for property rendering service. If net additions of \$6,265,068 be added to this total of \$75,177,603 the resulting value at December 31st, 1924, the date of the order complained of, is \$81,442,671. I do not include any value for construction in progress for the reason that it is unfinished property not yet used and useful in rendering service, the revenue which will be received when it is placed in service is not included in revenue as of the time of the inquiry, and because under the accounting practice of the company interest during construction on this unfinished property is added to its base cost on which a return is to be afforded by rates to be charged when placed in service. *Bluefield Water Works v. Public Service Commission*, 262 U. S. 690, indicates that the company is entitled to rates which are sufficient to yield a reasonable return on "the value of the property at the time it is being used to render the service. Construction in Progress is not in service and is not being used to render service.

As of December 31st, 1923, approximately five-eighths of this plant and equipment was installed at unit prices as of that date. Since that time central office equipment prices have been reduced and upwards of \$15,000,000 of gross additions to the property were made in 1924, with a result that nearly 70 per cent of the property in service December 31st, 1924, was installed at approximately July 1st, 1924, prices. From this it follows that approximately only 30 per cent of the property of the plaintiff company is subject to appreciation due to increase in unit prices now prevailing.

Approximate Cost to the State in Reaching Its Decision Set Forth in Exhibit "A" of the Bill of Complaint in This Matter

The magnitude of the case may be understood by considering that during the progress of this case fifty-five witnesses were examined on behalf of the company, five on behalf of the Board, five individuals and two municipal representatives complaining of service, making a total of sixty-seven witnesses. One hundred and twelve exhibits, containing 2,172 pages, were submitted by the company. Sixty-three exhibits, containing 345 pages, were prepared and submitted by the Board's experts, and five exhibits were submitted on behalf of the municipalities or associations. The total exhibits number one hundred and eighty, and the pages upward of 2,500; the testimony [fol. 234] amounted to 3,630 pages, making a total of over 6,000 pages. The rates were filed on March 6th, 1924, thirty-four hearings were held, and the decision and order was issued on December 31st, 1924, a period of nearly ten months.

I have made an inquiry as to the approximate cost to the State of the expenditures incurred on behalf of the State in arriving at the Board's decision and order set forth in detail in Exhibit "A" of the bill of complaint in this matter. On information and belief, I estimate that the cost of the time of the Commissioners, of special

telephone engineering experts and the Board's expert engineering and stenographic staff and of counsel will bring the total expenditures up to between \$85,000 and \$90,000, incurred in hearing, determining and rendering a decision and issuing its order in the application of the plaintiff in this case for increased rates.

John P. Petty.

Sworn and subscribed to before me this 13th day of March, 1925. (Sgd.) Helen D. Woodruff, Notary Public of New Jersey. (Seal.)

IN UNITED STATES DISTRICT COURT

[Title omitted]

AFFIDAVIT OF JOHN P. PETTY—Filed March 16, 1925

I have read carefully a transcript of the testimony adduced before the defendants at the hearing on the application of the plaintiff for approval of proposed increase in rates, under date of Wednesday, April 16, 1924, and find therein in the testimony of Harland A. Trax, a witness produced on behalf of the plaintiff telephone company, the following:

"Q. Those stations are used for intra and interstate business?

A. Private line stations are used for—may be used for intrastate or interstate business.

Q. Those you have referred to in your exhibits are used for both classes of business?

A. These are used for both intrastate and interstate service, yes, sir.

Q. (By Mr. Briggs:) Have you in any of these exhibits as to revenues, expenses, property or anything else, attempted to segregate as between interstate and intrastate business?

A. No, sir. All these exhibits show a total property and total revenue and expenses from all operations in New Jersey, including both interstate and intrastate service."

(Sgd.) John P. Petty.

Sworn and Subscribed to before me this 13th day of March, 1925. (Sgd.) Helen D. Woodruff, Notary Public of New Jersey. (Seal.)

[fol. 235]

IN UNITED STATES DISTRICT COURT

[Title omitted]

AFFIDAVIT OF JAMES G. WRAY ON 4.5 PER CENT. OR LICENSE CONTRACT—Filed March 16, 1925

STATE OF NEW JERSEY,
County of Essex, ss:

James G. Wray, being duly sworn on his oath, deposes and says:

I am the James G. Wray who made affidavit verified March 13th, 1925, in reply to affidavit of Henry C. Carpenter in this case. I have carefully read the affidavit of Tage P. Sylvan in this case, verified January 29th, 1925, relating to the license contract of plaintiff with the American Telephone and Telegraph Company and the alleged value of the services rendered to plaintiff by the American Company, for which plaintiff pays the American Company 4.5 per cent. of its gross revenues from telephone service.

The American Telephone & Telegraph Company, with the associate Bell Companies, constituting the Bell Telephone System, is a recognized monopoly furnishing telephone service throughout the United States. The plaintiff, the New York Telephone Company, is one of the associate companies of the Bell System and is a virtual monopoly rendering telephone service in the State of New Jersey. The American Telephone & Telegraph Company owns all but a few qualifying shares of the common stock of plaintiff and several other associate companies, and a majority of the common stock of all but two associate Bell companies, in which said companies it owns about one-third of the common stock, which gives it virtual control.

This plaintiff and the other associate companies of the Bell System have entered into contracts with the American Telephone & Telegraph Company, known as the "license contract," which was originally a license under which the operating company, now known as the associate company, was entitled to use the telephone owned by the licensor (The American Telephone & Telegraph Company and its predecessor the American Bell Telephone Company), under patents then in effect, and under which the licensor was to receive certain rentals for said telephones furnished by it. The original license contracts made no reference to other services of any kind. The rentals which at first amounted to approximately \$14.00 per year for a telephone set, consisting of a transmitter and receiver, were from time to time reduced until in 1902 they amounted to substantially \$2.50 per telephone set. The rentals charged were [fol. 236] on the basis of the number of telephone sets furnished and the total rental paid by the licensee increased with the expansion of its business. In 1902 the basis of payment under the license contract was changed from a rental per telephone set to an amount equaling 4.5 per cent. of the gross revenues from telephone service.

This change in basis of payment under the license contract made a slight temporary reduction in the compensation paid by the licensee under the license contract. The amounts paid by the licensee under the new license contract were made to increase not only with the expansion of the business but with any increases in telephone rates enjoyed by the licensee. The license contract was revised in 1902 only in respect to the method and basis of payment for telephone sets furnished to the licensee by the licensor and included no provision for other services to be furnished by the licensor to the licensee.

The license contract between the American Telephone and Telegraph Company and this plaintiff and between the American Company and other associate companies was again revised in 1920 to incorporate a variety of services which the American Company alleges to furnish to plaintiff and to require plaintiff to furnish certain services to the American Company. The only provision for services by the American Company to plaintiff in the original license contract and later contracts and included in the present license contract is the one characterized as the instrument service, under which the American Company furnishes to the plaintiff without compensation other than provided in the license contract the telephone instruments (transmitters, receivers and induction coils), used by plaintiff in furnishing telephone service.

Witness Sylvan in affidavits, page 143, says:

"* * * The supply of instruments furnished to the plaintiff include not only those used by subscribers but those used by the company in its own operations, such as operators' sets, testers' sets, and an adequate supply to be kept on hand by the plaintiff to provide for the growth of the business. In addition to the supply of instruments kept on hand by the plaintiff company the American Company is bound under the agreement to carry an adequate reserve stock sufficient to assure the plaintiff and other operating companies of an uninterrupted supply of instruments. * * *"

The American Company under the license contract is not "bound under the agreement to carry adequate reserve stock sufficient to assure the plaintiff and other operating companies of an uninterrupted supply of instruments." The license contract does require the American Company to furnish instruments to the plaintiff to the amount of 3 per cent. in excess of the number of instruments in use. The plaintiff under the contract must pay the American Company \$9.00 per year for all instruments received by it in excess of said 3 per cent. allowance.

Witness Sylvan on affidavits, page 143, says:

"* * * Whenever improvements in the type of instrument are made the plaintiff may return its instruments of an older type and without additional charge obtain the improved type of instrument. * * *"

[fol. 237] The license contract provides that plaintiff "may choose from such standard patterns" of instruments that the American Company may have adopted as standard patterns. The American Company is not required under the contract to make standard its improvements in telephones and telephone apparatus.

On page 144 of affidavits Sylvan describes the development and research activities of the American Company. The amount and character of development and research work done by the American Company for the plaintiff under the license contract is determined by the American Company and not by the plaintiff. Under the license contract the plaintiff is required to pay for services which it may not demand and over which it has no control.

Witness Sylvan, on page 146 of affidavits, alleges that the American Company has acquired and owns upwards of 4,000 patents related to the telephone art and says:

"The use of all such patents is given to the plaintiff and other licensee companies without payment of any royalty or without charges of any kind."

Plaintiff has no option as to the patents which it will use as patented devices are developed and made standard only at the option of the American Company.

Witness Sylvan, on page 148 of affidavits, in referring to alleged financial services of the American Company to plaintiff, says:

"Through this service the plaintiff was relieved of the necessity of borrowing in the open market at higher rates of interest and the financing for a given period by the issuance of securities in much larger amount than would be necessary for present requirements."

Plaintiff did, in 1920, borrow \$5,000,000 from a New York bank and paid 6 per cent. interest.

Witness Sylvan, on page 150 of affidavits, when referring to the estimated annual carrying charges to plaintiff if it were required to replace the telephone instruments (transmitter, receiver and induction coil) now furnished to it by the American Company, says:

"The added expense to the New York Company in form of annual carrying charges on such instruments with the necessary surplus stock required would amount to at least one dollar per station, or a total as of December 31st, 1924, of Two Million Two Hundred Fifty Thousand Dollars (\$2,250,000)."

Sylvan's estimate is based upon the assumption that plaintiff would have to purchase said telephones at substantially market prices in small quantities. The cost to the American Company of said telephones which it furnishes to plaintiff is only a little more than half the market price. Plaintiff should be able to purchase said telephones in large quantities at much less than the figures used by Sylvan. The annual carrying charges to plaintiff for telephones

purchased in the large quantities which it would have to purchase should be substantially less than the \$1.00 per station estimated by Mr. Sylvan.

The development and research work done by the American Company under the license contract is not alone for the Associate Companies but for the toll service and especially for the long distance [fol. 238] service of the American Company and for telegraph, radio, the transmission of pictures and other purposes.

The services furnished by the American Company to plaintiff under the license contract are largely related to the design and construction of the property itself and are properly chargeable, at least in part, to the capital accounts. Plaintiff treats them all as in the nature of preferred expenses and deducts them from revenue before all other expenses.

The services furnished by the American Company to plaintiff under the license contract are valuable but the actual value is unknown to me. It is my opinion, in view of the fact that plaintiff is owned by the American Company, that such services should be furnished to it at as near cost as practicable.

(Sgd.) James G. Wray.

Sworn and subscribed to before me this 13th day of March, 1925. Helen D. Woodruff, Notary Public of N. J. (Seal.)

IN UNITED STATES DISTRICT COURT

[Title omitted]

AFFIDAVIT OF JAMES G. WRAY ON WORKING CAPITAL—Filed March 16, 1925

STATE OF NEW JERSEY,
County of Essex, ss:

JAMES G. WRAY, being duly sworn, deposes and says:

I am the James G. Wray who made affidavit verified March 13, 1925, in reply to affidavit of Henry C. Carpenter in this case.

The plaintiff's working capital consists of:

1. The net amount of money which the plaintiff has paid out to meet the current expenses of giving telephone service in advance of the collection of the corresponding revenues derived from services rendered.

[fol. 239] 2. The average Working Cash balances which the plaintiff must keep on hand in order to operate its telephone business.

3. The average materials and supplies necessary for operation of the plaintiff's plant.

A thorough investigation of the plaintiff's business made by me,

and others under my direction, including information obtained from the records of the plaintiff, shows the above three items as of December 31, 1923, to be as follows:

1.	\$184,679
2.	300,000
3.	622,035

Total Working Capital	\$1,406,714
-----------------------------	-------------

This amount, adjusted to July 1, 1924, on a per station basis, the defendant from the evidence adduced at the hearing before it found to be \$1,770,000.

Item 1 was derived directly from the records of the plaintiff's monthly billing, collections, and operating expenses during the last two years.

Item 3 is the average book cost for materials and supplies as given in plaintiff's exhibit numbered P. 27 in the hearing before defendant.

Item 2 was obtained from a study of the cash balances maintained by the plaintiff during the last three years. Particular attention was given to the range of fluctuations of these balances from their maximum to their minimum amounts, as indicative of the cash reserves actually needed to cover periods of maximum cash expenditures. The minimum cash balances required by the banks to carry plaintiff's accounts and render certain commercial services were considered in estimating the minimum below which the Working Cash should not be allowed to fall.

The allowance by the defendant for working capital for operating was based upon a careful consideration by it of all of the testimony before it, bearing on this subject, as a reading of the defendant's decision will show. The allowance so made was not \$700,000 less than the "working cash capital" "provided in recent years by plaintiff as shown by its records" as alleged by the affiant Whittemore, but, on the contrary was the amount indicated by the records of the company as reasonably required for working capital for operating. It is true that the amount allowed was less than that claimed by the affiant Whittemore, as a witness before the defendant, for working capital, but the claim made by him was not based as he alleges upon the amounts the plaintiff "had been actually providing and using in recent years as working capital" for operating, but upon his estimate. This is indicated by his testimony on page 21 of plaintiff's affidavits where he says, "From the working cash items, as used by me, I excluded all cash applicable to the payment of interest, dividends or taxes, as well as cash received from sale of securities wherewith to build or enlarge plaintiff's property."

Whittemore does not say that he has excluded the cash for building and enlarging its property, received by plaintiff from the rate [fols. 240 & 241] payers through charges for depreciation or borrowed on notes.

(Sgd.) James G. Wray.

Sworn and subscribed to before me this 13th day of March, 1925. Helen D. Woodruff, Notary Public of N. J. (Seal.)

[fol. 242]

IN UNITED STATES DISTRICT COURT

[Title omitted]

Before Buffington, Circuit Judge, and Rellstab and Morris, District Judges

OPINION—Filed May 2, 1925

BUFFINGTON, Circuit Judge:

The Plaintiff, New York Telephone Company, owns and operates a telephone system located in New York, Connecticut and the north-easterly section of the State of New Jersey. It furnishes both interstate and intra-state telephone service. Its rates for "exchange" service within the state of New Jersey having remained substantially the same for about ten years and its expenses having greatly increased the plaintiff requested the defendant, the Board of Public Utility Commissioners of the State of New Jersey, the body having jurisdiction over that matter (c. 195 Laws of 1911), to be permitted to increase its rates for service of that character. To that end if filed, on March 6, 1924, with the Board a schedule of increased rates for such service. A hearing was ordered by the defendant to determine whether the rates submitted were just and reasonable. Pending the hearing and determination the new rates were suspended by orders of the Board and stipulation of the parties. By its decision and order, filed on December 31, 1924, the Board disallowed the increase directed that the plaintiff carry its depreciation account in a specified manner and that the schedule of rates then in force be continued. Thereupon the plaintiff filed its bill of complaint herein, alleging, in effect, that the Board in making such order has exceeded its jurisdiction in that, among other [fol. 243] things, the rates to which the plaintiff became thereby restricted are so inadequate, unfair, and unreasonable as to be confiscatory and, hence, in violation of the Constitution of the United States. It prays that the defendants be enjoined from enforcing the order, and likewise, from interfering with the plaintiff's putting into effect the schedule of rates disallowed by the Board. The present application, made under section 263 of the Judicial Code, is for an interlocutory injunction pending the trial and comes before the court on bill, answer and affidavits.

The plaintiff bases its allegation of confiscation mainly upon the contention that even if it be assumed that a rate of return of 7.53 per centum, found by the Board to be fair and reasonable and seemingly obtainable by the plaintiff under the Board's order, is in fact fair, reasonable and non-confiscatory, yet the truth is that, under that order, the maximum rate of return actually permitted the plaintiff is far less than 7.53 per centum. In support of this main contention the plaintiff urges (1) that the value of plaintiff's property, as fixed by the Board and upon which it based the rate, is substantially less than the actual value of the property; (2) that

the amount fixed by the Board to be charged as an expense for depreciation is substantially less than the loss sustained by plaintiff by reason of actual normal depreciation; and (3) that the Board acting upon a finding made by it that the plaintiff had in the past made excessive charges for depreciation and upon its view of the law that such excessive charges in the past could be offset by correspondingly inadequate depreciation charges in the future, denied to the plaintiff the right to charge as an expense the amount representing the actual current depreciation loss, even as ascertained by the Board, and required the plaintiff to deduct from such actual depreciation, until such time as such past excess charges shall have been absorbed, "an amount sufficient to allow the net telephone earnings for a given period (month or year) to equal a fair return on the value of the property in service" as found by the Board.

[fol. 244] The solution of plaintiff's first and second subordinate contentions turns mainly upon matters of fact. The only facts before us are those disclosed by the ex parte affidavits filed in this cause. As the affidavits are conflicting it is not possible for us, upon this preliminary hearing, to determine what is the proper valuation of plaintiff's property or what is the proper amount to be charged as a depreciation expense. Consequently, for the purposes of this motion, we must assume, that the valuation of the property and the normal depreciation charge as shown by the defendant's affidavits are correct. It follows that the first and second subordinate contentions of the plaintiff cannot be sustained.

Passing to the plaintiff's third subordinate contention it is manifest that the questions thereby presented to us are two. First, whether the Board may now be heard to say with retroactive effect that the charges made in the past by the plaintiff were excessive; and, second, even if it be conceded that they were, whether that fact would confer upon the defendant the right and power to base an order with respect to future rates upon a result or rate of return obtained by allowing to the plaintiff as a depreciation expense a sum less than the Board itself finds to be the actual, normal, currently accruing depreciation. We think the former of these two questions must be answered in the negative. Since 1912 the intrastate rates of the plaintiff in the State of New Jersey have been subject to the supervision of the Board. During all that time the Board has had the power to investigate plaintiff's rates, ascertain whether plaintiff's charges to expense for depreciation were excessive and, by fixing a just and reasonable rate, correct any excessive rates or charges that it might find. (Chap. 195, Sec. 16 laws of 1911). The board did not act. The presumption now is that all profits from plaintiff's business were lawfully acquired. *Newton v. Consolidated Gas Co.*, 258 U. S. 165, 175, and became a lawful part of plaintiff's property. Even if such presumption be a rebuttable one, which we do not decide, the evidence before us is not [fol. 245] sufficient to overcome it.

In considering the second of the immediately foregoing questions it is essential to remember that the property upon the value of which the plaintiff is entitled to a non-confiscatory return is the

property (not part of it) that is being used in the service as of the time the inquiry the rates is made. *Willcox v. Consolidated Gas Co.*, 212 U. S. 19, 52. The Supreme Court has also expressly held that "When * * * a public regulation of its price comes under question the true value of the property then employed for the purpose of earning a return cannot be enhanced by a consideration of the errors in management which have been committed in the past." *Knoxville v. Water Co.*, 212 U. S. 1, 14. The principle and result would seem to be the same whether the value of the property has been diminished by past inadequate rates or enhanced by past excessive rates. It has, in effect, been so held. *Garden City v. Garden City Telephone, Light & Mfg. Co.* 236 Fed. 693; *Monroe Gas-light & Fuel Co. v. Michigan P. U. Commission*, 292 Fed. 139. Such being the property upon whose value the plaintiff is entitled to a non-confiscatory rate of return it inevitable follows, as we see it, that a confiscatory rate of return thereon cannot be converted into a non-confiscatory one merely by ignoring depreciation losses or expenses or by considering such item to be less than it actually is. Obviously if the property upon which a plaintiff is entitled to a non-confiscatory rate must be absorbed in whole or in part in order to provide such rate there is confiscation. The rate of return afforded by the present order of the defendant, even if defendant's own valuation of plaintiff's property and defendant's own estimate of actual and normal depreciation be used, is, as shown by an affidavit filed by the defendant, only 4.93 per centum. The authorities are unanimous in holding that such a rate for telephone property is confiscatory. Moreover the defendant makes no contrary contention. It appears to be clear from the evidence that the rate of return upon the property employed by the plaintiff in its intra-[fols. 246 & 247] state business in New Jersey is even less than the rate of return upon the value of the property there used in the inter-state and intra-state business combined. It follows that the order of the defendant is confiscatory and invalid and the enforcement of same must be enjoined.

Counsel for the respective parties are directed to file with the clerk of this court at twelve o'clock noon, Eastern Standard time, on Thursday the 7th day of May, 1925, four copies of such order or decree as they will suggest to the court for entry and Tuesday the 12th day of May, 1925, at nine o'clock in the forenoon, Eastern Standard Time at Trenton, New Jersey, is set for a hearing with respect to the order to be entered.

[fol. 248] [File endorsement omitted.]

[Title omitted]

ORDER FOR INTERLOCUTORY INJUNCTION—Filed May 12, 1925

This cause came on to be heard before the Honorable Joseph Buffington, Circuit Judge of this Circuit, and the Honorable John Rellstab and the Honorable Hugh M. Morris, District Judges, pursuant to the order to show cause made and filed herein on the 29th day of January, 1925, upon the motion of the plaintiff for an interlocutory injunction in accordance with the prayer set forth in its bill of complaint, also filed herein on the 29th day of January, 1925, and not less than five days' notice of the hearing of said motion having been given to the Governor and to the Attorney General of the State of New Jersey and to each of the defendants herein, and said motion having been argued by counsel for all the parties; and the Court having considered the bill of complaint and the answers herein and the affidavits and exhibits filed by the respective parties hereto, and being of opinion that the order of the defendants of December 31, 1924 (Exhibit A attached to the Bill of Complaint), is confiscatory and invalid, and that the enforcement of the same should be enjoined;

It is, on this 12th day of May, 1925

Ordered, adjudged and decreed by this Court constituted as provided by section 266 of the Judicial Code, that the defendant Board of Public Utility Commissioners and the defendants Joseph F. Autenreith, Frederick W. Gnichtel and Charles Browne, the persons constituting said Board of Public Utility Commissioners, and all other persons, be and they are hereby severally enjoined and restrained, pending the trial and determination of this cause and until the fur-[fol. 249½] ther order of the Court, from attempting to compel the plaintiff, its officers, agents and employees, to observe or keep in force the rates for telephone service required to be continued in effect by said order of December 31, 1924, or otherwise to observe or comply with any of the provisions of said order of the defendants, and that the defendants be and they are enjoined hereby until the further order of the court from taking any steps or proceedings against the plaintiff, its officers, agents or employees, to enforce any penalties or any other remedy against the plaintiff for disregarding the said order; and it is

Further ordered, adjudged and decreed that the plaintiff shall file with the Clerk of this Court within fifteen days from the date of this order and decree a good and sufficient bond with the American Telephone and Telegraph Company as surety, or with other good and sufficient surety, in the penal sum of two million dollars (\$2,000,000), in form to be approved by a Judge of this Court, conditioned upon the prompt payment to the defendants of all costs and damages which may be incurred or suffered by any party to this suit who may be found to have been wrongfully enjoined or restrained hereby, and further conditioned so that in the event that this interlocutory

injunction order shall be hereafter dissolved, the plaintiff will repay to the several subscribers affected hereby, with interest, in such manner and to such extent as the Court may direct, any sums hereafter and until the further order of the court paid by them for telephone service furnished by the plaintiff, in excess of the sums chargeable to them under or pursuant to the provisions of the said order of the defendants of December 31, 1924, the enforcement of which is hereby enjoined and restrained; and further conditioned so that any of said excess sums, with interest, which shall have been repaid by the plaintiff within a period of two years from the date of the entry of a final decree herein to the persons entitled thereto, [fol. 250] shall be immediately reported by the plaintiff to this court with the names and addresses of the several persons entitled thereto as shown by the books and records of the plaintiff, and that the plaintiff will thereafter hold and pay all such sums to the Clerk of the District Court of the United States for the District of New Jersey or to such person or persons and in such manner and to such extent and at such time or times as this Court shall by its order or orders direct; and it is

Further ordered, adjudged and decreed that this interlocutory injunction is granted upon condition that the plaintiff shall not hereafter charge or collect for telephone service furnished by it in the State of New Jersey so long as this order continues in effect, rates in excess of the rates for telephone service made and filed by the plaintiff with the defendant Board of Public Utility Commissioners on March 6, 1924, to become effective April 1, 1924, and which rates were suspended and subsequently disapproved by the defendants by the said order of December 31, 1924, the enforcement of which is hereby enjoined and restrained; and shall not charge rates in excess of those required to be kept in effect by said last mentioned order of the defendants until after the 31st day of May, 1925, and it is

Further ordered, adjudged and decreed that hereafter and so long as this order shall continue in effect, all bills sent by the plaintiff to its subscribers for telephone service, to which the said order of the defendants of December 31, 1924, which is hereby enjoined and restrained, would otherwise apply, shall bear a statement or have enclosed therewith a printed card or paper setting forth a notice in substantially the following words:

[fol. 251]

Notice to Subscribers

Keep the enclosed bill. If the suit of the Company in the United States District Court for the District of New Jersey is dismissed, you may be entitled to a refund, and the enclosed bill will be evidence of the amount for which you have been charged.

New York Telephone Company.

(Signed) Joseph Buffington, Circuit Judge. (Signed) John Rellstab, (Signed) Hugh M. Morris, District Judges.

The foregoing interlocutory injunction order and decree is hereby approved as to form.

Dated Newark, New Jersey, May 8, 1925.

(Signed) Frankland Briggs, Wall, Haight, Carey & Hartpence. (Signed) Thomas G. Haight, Solicitors for Plaintiff. (Signed) Thomas Brown, (Signed) John Wahl Queen, Solicitors for Defendants.

[fol. 252] [File endorsement omitted.]

[fol. 253]

Copy

IN UNITED STATES DISTRICT COURT

INJUNCTION AND MARSHAL'S RETURN—Filed May 26, 1925

THE UNITED STATES OF AMERICA,
District of New Jersey, ss:

The President of the United States of America, to Board of Public Utility Commissioners, and Joseph F. Autenrieth, Frederick W. Gnichtel and Charles Browne, constituting said Board, Greeting.

Whereas, New York Telephone Company, a corporation, has filed on the equity side of the District Court of the United States for the District of New Jersey, a bill of complaint against the Board of Public Utility Commissioners, Joseph F. Autenrieth, Frederick W. Gnichtel and Harry V. Osborne (in whose stead Charles Browne has since been substituted as a defendant), constituting said Board, and has obtained an order for an interlocutory injunction as prayed for in said bill; Now, therefore, we having regard to the matters in said bill contained, do hereby command and strictly enjoin you, the said Board of Public Utility Commissioners, Joseph F. Autenrieth, Frederick W. Gnichtel and Charles Browne, constituting said Board, pending the trial and determination of the said cause and until the further order of our said District Court, from attempting to compel the said New York Telephone Company, its officers, agents and employees, to observe or keep in force the rates for telephone service required to be continued in effect by the order made by you on December 31, 1924, copy of which is attached to the said bill of complaint as Exhibit A, or otherwise to compel said New York Telephone Company, its officers, agents and employees, to observe or comply with any of the provisions of your said order; and you are further commanded and strictly enjoined hereby until the further order of our [fol. 254] said District Court from taking any steps or proceedings against the said New York Telephone Company, its officers, agents or employees, to enforce any penalties or any other remedy against the said New York Telephone Company for disregarding your said order, which commands and injunctions you are respectively re-

quired to observe and obey until our said District Court shall make further order in the premises.

Hereof fail not, under penalty of the law thence ensuing.

Witness, the Honorable William H. Taft, Chief Justice of the Supreme Court of the United States, at Trenton, New Jersey, in said District, this 23d day of May, 1925.

George T. Cranmer, Clerk of the District Court of the United States for the District of New Jersey, by R. S. Chevrier, Deputy. (L. S.)

Served the within injunction on the Board of Public Utilities Commissioner by delivering to and leaving with Albert Barber, Chief Clerk to said Commissioner a copy thereof at Trenton in the Dis. of N. J. on the 25th day of May, 1925 at the same time showing said person this original with the seal of the Court attached and informing him of its contents.

Jas. M. Mulheron, U. S. Marshal, Thos. Colclough, Deputy.

[fol. 255] [File endorsement omitted.]

[fols. 256-261] BOND ON INJUNCTION FOR \$2,000,000—Approved and Filed May 23, 1925; omitted in printing

[fols. 261a & 261b] CITATION—In usual form, showing service on Frankland Briggs; omitted in printing

[fol. 262] IN UNITED STATES DISTRICT COURT

[Title omitted]

PETITION FOR AND ORDER ALLOWING APPEAL—Filed May 29, 1925

The defendants in the above entitled cause, feeling themselves aggrieved by the interlocutory order or decree of this court entered in said cause on the 12th day of May, 1925, awarding to the plaintiff a preliminary injunction herein as prayed for by the plaintiff in its bill of complaint, do hereby jointly and severally appeal from the said interlocutory order or decree, to the Supreme Court of the United States, for the reasons set forth in the assignment of errors filed herewith; and said defendants jointly and severally pray that their appeal be allowed from the said interlocutory order or decree to the Supreme Court of the United States, and that a citation be issued as provided by law, and that a transcript of the records, proceedings and documents upon which said interlocutory order or decree was based, and of the opinion rendered herein, duly au-

thenticated, be sent to the United States Supreme Court under the Rules of said court in such cases made and provided.

[fol. 252½] And your petitioners further pray that an order be made dispensing with security to perfect their appeal as aforesaid.

Dated, Newark, N. J., May 21, 1925.

Joseph F. Autenrieth, Chairman, Board of Public Utility Commissioners. Thomas Brown, Solicitor and Counsel for Board of Public Utility Commissioners, and Harry V. Osborne, Joseph F. Autenrieth and Frederick W. Gnichtel, constituting said Board, Defendants.

Appeal herein allowed and bond to cover costs of appeal is hereby dispensed with.

Dated, 29th May, 1925.

John Rellstab, Judge.

[fol. 263] [File endorsement omitted.]

fol. 264]

IN UNITED STATES DISTRICT COURT

[Title omitted]

ASSIGNMENT OF ERRORS—Filed May 29, 1925

The above named defendants-appellants, Board of Public Utility Commissioners, Harry V. Osborne, Joseph F. Autenrieth and Frederick W. Gnichtel constituting said Board in connection with their petition for appeal in the above entitled action, file the following assignment of errors upon which they will rely in their prosecution of the appeal in said cause, from the interlocutory order or decree of this court entered in said cause, on the 12th day of May, 1925, awarding to the plaintiff a preliminary injunction herein as prayed for by the plaintiff in its bill of complaint, and say that in the record, proceedings and in the said interlocutory order or decree aforesaid, manifest error has intervened, to the prejudice of the appellants, to wit:

1. The court erred in not holding that the bill of complaint does not state facts sufficient to constitute a cause for action, and in not refusing the injunction, and in not dismissing the suit and bill of complaint.

2. The court erred in granting a preliminary injunction, decreeing that defendants be enjoined pending the determination of this cause, from attempting to compel plaintiff to enforce or to keep in force the rates for telephone service prescribed by the order of Dec[ember] 31, 1924, of said defendant Board of Public Utility Commissioners of New Jersey, and from taking any proceedings against plaintiff, to enforce any penalties or any other remedies for disregarding the rates prescribed by said orders.

3. The court erred in holding that the said order is void and deprives plaintiff of its property without due process of law or denies to plaintiff the equal protection of the laws in violation of the Constitution and of the Fourteenth amendment thereto.

4. The court erred in holding that although the defendant Board of Public Utility Commissioners may have properly found that the plaintiff had in the past made excessive charges for depreciation and had accumulated an excessive amount for depreciation reserve, said Board did not lawfully have the power to fix a correspondingly lower depreciation charge for such time as it may take to absorb such past excess charges, and that its said order in that respect confiscates plaintiff's property and violates the Fourteenth Amendment to the Constitution of the United States.

5. The court erred in holding that the provisions of the said order of the defendant Board requiring the plaintiff, in view of the excess in its depreciation reserve, to make up any deficiency in its earnings by thereafter reducing the percentage of its revenue charge to depreciation reserve are illegal and beyond the power of defendants and would if enforced confiscate the property of the plaintiff in violation of the Fourteen Amendment to the Constitution of the United States.

[fol. 265½] 6. The court erred in holding that the depreciation percentage required to be charged by the plaintiff to "Depreciation Expense" account and "Amortization of Landed Capital Account" by said order confiscate the property of the plaintiff in violation of the Fourteenth Amendment to the Constitution of the United States.

7. The court erred in holding that the State of New Jersey and the defendant Board were precluded in fixing just and reasonable rates for the services of plaintiff from taking into account the excess in the amount accumulated for depreciation reserve.

8. The court erred in holding that such excess in the amount accumulated for depreciation reserve was the absolute and unqualified property of plaintiff.

9. The court erred in ignoring the fact that deducting the amount remaining as depreciation reserve from the fair value found for plaintiff's property as new, in lieu of deducting therefrom the depreciation actually accrued, the return that would be afforded under the defendant's said order would be a fair return.

10. The court erred in holding that the rates for telephone service required by the said order of the defendant Board to be continued in force confiscate the property of the plaintiff in violation of the Fourteenth Amendment to the Constitution of the United States.

Wherefore, the appellants pray that the said interlocutory order or decree of injunction be reversed and that said District Court for [fol. 266] the District of New Jersey be directed to enter an order

or decree reversing said decision and order and decree of the lower court in this suit.

Dated, Trenton, N. J., May 22, 1925.

Thomas Brown, Solicitor for Board of Public Utility Commissioners and Harry V. Osborne, Joseph F. Autenrieth and Frederick W. Gnichtel, constituting said Board, Defendants.

[fol. 270] IN UNITED STATES DISTRICT COURT

[Title omitted]

STIPULATION SUBSTITUTING CHARLES BROWNE IN PLACE OF DEFENDANT H. V. OSBORNE—Filed June 4, 1925

The defendant Harry V. Osborne having prior to the allowance of the appeal herein ceased to be a member of said Board of Public Utility Commissioners, and Charles Browne having become a member of said Board in the place of said Harry V. Osborne and order having been entered herein substituting the said Charles Browne in the place of said Harry V. Osborne as a defendant, it is hereby stipulated that the papers and proceedings including the petition of appeal, the assignment of errors and the citation on appeal herein be amended by substituting the name of Charles Browne in the place of Harry V. Osborne wherever it appears.

Dated June 3, 1925.

Frankland Briggs, Wall, Haight, Carey & Hartpence, Solicitors of Plaintiff. Thomas Brown, Solicitor of Defendants.

[fol. 271] [File endorsement omitted.]

[fol. 272] IN UNITED STATES DISTRICT COURT

[Title omitted]

STIPULATION RE TRANSCRIPT OF RECORD—Filed June 4, 1925

It is hereby stipulated and agreed that the true transcript of the record of the said District Court in the above entitled matter consists of the following:

Subpœna.

Complaint with plaintiff's Exhibits and Affidavits.

Answers of defendants with Affidavits.

Opinion.

Decree and writ of injunction.

Bond on restraining order.

Petition for appeal and order of allowance

Assignment of errors.

Citation.

Stipulation re substitution of Charles Browne as defendant in lieu of Harry V. Osborne.

Frankland Briggs, Wall, Haight, Carey & Hartpence, Solicitors for Plaintiff. Thomas Brown, Solicitor for Defendants.

[fol. 273] [File endorsement omitted.]

IN UNITED STATES DISTRICT COURT

CLERK'S CERTIFICATE

I, George T. Cranmer, Clerk of the District Court of the United States of America, for the District of New Jersey, in the Third Circuit, do hereby certify the foregoing to be The Transcript of Record on Appeal in the case of Board of Public Utility, Commissioners, et al. Appellants—against—New York Telephone Company. Appellees, on file, and now remaining among the records of the said Court, in my office.

In Testimony Whereof, I have hereunto subscribed my name and affixed the seal of the said Court, at Trenton, in said District, this 16th day of June, nineteen hundred and twenty-five.

George T. Cranmer, Clerk District Court, U. S., by Charles S. Chevrier, Deputy. (Seal of District Court of the United States, District of New Jersey.)

File No. 31,290. New Jersey D. C. U. S. Term No. 567. Board of Public Utility Commissioners and Harry V. Osborne, Joseph F. Autenreith, et al., etc., appellants, vs. New York Telephone Company. Filed June 26th, 1925. File No. 31,290.

(19)

STIPULATION AND ADDITION TO RECORD

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1925

No. 567

**BOARD OF PUBLIC UTILITY COMMISSIONERS ET AL.,
APPELLANTS,**

vs.

NEW YORK TELEPHONE COMPANY

**APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR
THE DISTRICT OF NEW JERSEY**

FILED DECEMBER 29, 1925

(31,290)

(31,290)

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1925

No. 567

BOARD OF PUBLIC UTILITY COMMISSIONERS ET AL.,
APPELLANTS,

vs.

NEW YORK TELEPHONE COMPANY

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR
THE DISTRICT OF NEW JERSEY

INDEX

	Original	Print
Stipulation re printing reply affidavits.....	<i>a</i>	1
Affidavit of Frankland Briggs as to alleged refusal of information	1	1
Affidavit of Paul H. Burns as to alleged refusal of information.	5	3
Affidavit of George W. Whittemore in reply to answering affidavit of Cyrus G. Hill on depreciation.....	9	6
Affidavit of Andrew Sangster in reply to answering affidavit of Cyrus G. Hill.....	13	8
Affidavit of Henry C. Carpenter in reply to answering affidavit of J. G. Wray.....	17	10
Affidavit of H. A. Trax in reply to answering affidavits of Hill and Wray.....	21	11
Affidavit of Andrew Sangster in reply to Wray affidavit on separation	24	13

[fol. a] **IN THE SUPREME COURT OF THE UNITED STATES**

STIPULATION RE PRINTING REPLY AFFIDAVITS—Filed December 29,
1925

The reply affidavits of plaintiff-appellee (a copy of which is annexed hereto) having been inadvertently omitted from the transcript of the record,

It is stipulated and agreed that they shall nevertheless constitute a part of the record on appeal, and that the Clerk of the Supreme Court of the United States shall print the same as part of said record and shall include them in the transcript already printed or in a supplement thereto as he may determine is proper.

Thomas Brown, Counsel for Appellants. Thomas E. Haight, Counsel for Appellee.

[fol. 1] **DISTRICT COURT OF THE UNITED STATES, DISTRICT OF NEW JERSEY**

In Equity

NEW YORK TELEPHONE COMPANY, Plaintiff,

against

BOARD OF PUBLIC UTILITY COMMISSIONERS and HARRY V. OSBORNE, Joseph F. Autenreith, and Frederick W. Gnichtel, Constituting said Board, Defendants

AFFIDAVIT OF FRANKLAND BRIGGS AS TO ALLEGED REFUSAL OF INFORMATION

STATE OF NEW YORK,
County of New York ss:

Frankland Briggs, being duly sworn, deposes and says:

I am one of the solicitors for the plaintiff and the same Frankland Briggs who made an affidavit in this suit, verified the 29th day of January, 1925.

The answering affidavits of the defendants were not served upon and received by the solicitors for the plaintiff until sometime in the forenoon of Saturday, March 14, 1925.

I have read the affidavit of Cyrus G. Hill, verified the 11th day of March, 1925, and filed by defendants in this suit. At page 32 thereof the following statement is made:

"On or about February 18th, I requested Plaintiff through its [fol. 2] counsel to furnish information respecting the retirement unit costs heretofore used by Plaintiff in valuing its property when retired

and my request for such information or for access to the Plaintiff's records showing said retirement unit costs was denied."

The above statement is misleading as more fully appears herein after.

I have also read the affidavits of James G. Wray, verified the 13th day of March, 1925. At page 47 thereof the following statement is made:

"I have requested counsel for Plaintiff to furnish the data actually used in the segregation of intrastate telephone service and permit me to examine the computation, showing such segregation of property, revenues and expenses, but this request has been denied."

At page 54 thereof the following statement is made:

"Counsel for Plaintiff has refused to furnish me the data compiled and the computations made by Plaintiff in making such segregation," etc.

Each of the two above statements is untrue, as more fully appears hereinafter.

The said Cyrus G. Hill and James G. Wray and staff of persons employed by them have been engaged for more than a year last past in making investigations in connection with plaintiff's property, revenues, expenses, service and other matters, both in the states of New Jersey and New York. During said period the plaintiff has had a suit in equity involving its telephone rates in the state of New York pending in the United States District Court for the Southern District of New York and also a proceeding before the Public Service [fol. 3] Commission of the State of New York, and during a great part of said period proceedings involving its rates in the state of New Jersey pending before the defendants in this suit. During all that time the said Hill and Wray and their staff have been afforded offices and office space in the plaintiff's building at No. 15 Dey Street, New York City, rent free and have been furnished in connection therewith lighting, telephone service, etc., without charge. The said Hill and Wray and their associates have during all of said period been furnished practically unlimited access to all the books, records, data and papers of the plaintiff company and with other information of a varied character as has been requested by them from time to time. In view of the several proceedings, both before the commissions and the courts, in which the plaintiff was involved and represented by different counsel and as to which information was requested by said Hill and Wray and their associates from time to time, it was, on or about June 20, 1924, arranged definitely that all requests for records and information, etc., in whatever case or proceeding required, should be made through one channel, namely, Mr. Paul H. Burns, an attorney at law, who is associated with me in my office and was designated by me especially to handle such requests.

Written requests for the information above referred to in the extracts from the affidavits of the said Hill and Wray, dated March 3, 1925, were submitted to me in person by Mr. James G. Wray on March 4, 1925. Said written requests were presented to me at a conference held in my office, No. 15 Dey Street, New York City, at which were present Mr. James G. Wray, said Paul H. Burns and Mr. John P. Petty, who is Deputy Chief Engineer of the Bureau [fol. 4] of Utilities of the defendant board. At said conference, when these requests were made, I stated that I was not at liberty to furnish them with computations and other data in the nature of special studies which were not kept in the regular course of business. I stated, however, that I would discuss their requests with other counsel associated with me in this suit and would advise them. Immediately when said Wray and Petty left my office I took up the matter with my associate counsel and it was decided to make available to said Wray and Petty the information which they had requested. I so advised Mr. Burns and requested him to in turn advise Messrs. Wray and Petty. As will more fully appear in the affidavit made by Mr. Burns, which is hereto attached and also verified March 16th, 1925, said Wray and Petty were advised by telephone on March 4, 1925, the same day on which the requests for the information had been presented, that the plaintiff would make available to them the information they had requested, and such compliance with their request was confirmed by letters addressed to J. G. Wray & Company, which is the company with which the said James G. Wray is associated, under date of March 6, 1925, which were signed by Mr. Burns in my name, and copies of which are set forth in his affidavit.

(Sd.) Frankland Briggs.

Subscribed and sworn to before me this 16th day of March, 1925. (Sd.) Lincoln Jones, Notary Public, Kings Co. No. 31. Cert. filed in N. Y. Co. No. 66. Kings Co. Register No. 6033. N. Y. Co. Register No. 6060. (Seal.)

[fol. 5] IN UNITED STATES DISTRICT COURT

[Title omitted]

AFFIDAVIT OF PAUL H. BURNS AS TO ALLEGED REFUSAL OF INFORMATION

STATE OF NEW YORK,
County of New York, ss:

Paul H. Burns, being duly sworn, deposes and says:

I reside at 77 Parkway East, Bloomfield, New Jersey. I am an attorney employed by the plaintiff in the office of Frankland Briggs, one of its solicitors in this suit. I have read the statements con-

tained in the affidavits of Cyrus G. Hill and James G. Wray referred to in the attached affidavit of Frankland Briggs, which I have also read.

I was present at the conference in Mr. Briggs' office on March 4, 1925, referred to in said affidavit and am familiar with the requests submitted in writing at that conference. The statements made to [fol. 6] Messrs. Wray and Petty by Mr. Briggs at such conference are set forth correctly in his affidavit. Within one hour after the conclusion of said conference on March 4, 1925, I was advised by Mr. Briggs that the plaintiff would make available to said Wray and Petty the information asked for. Later in the day I advised both Messrs. Wray and Petty by telephone to the effect that such information would be made available as subsequently confirmed by letters addressed to Mr. Wray dated March 6, 1925, and signed by me in the name of Frankland Briggs. The request for information referred to by Cyrus G. Hill in his affidavit related to the retirement unit costs used by plaintiff in making retirements of its property, and the same request was contained in one of the said letters presented to Mr. Briggs on March 4, 1925. The answer to such request was as follows:

"4-1002-2.F

March 6, 1925.

J. G. Wray & Company, 15 Dey Street, New York City.

Attention Mr. J. G. Wray

DEAR SIR: In compliance with the request contained in your letter of March 3, 1925, arrangements have been made whereby your representatives may have access to this company's record of retirement unit costs used in northern New Jersey from 1909 to 1921, inclusive, in so far as such records are available, upon application to Mr. I. J. Thorp, general plant supervisor, 15 Dey Street, New York City.

Yours very truly, (Signed) Frankland Briggs, Attorney in Charge of Commission Matters."

[fol. 7] The requests for information referred to by Mr. Wray in his affidavit related to information concerning the figures in the moving papers relative to the segregation of property, revenues and expenses in New Jersey as between interstate and intrastate service, respectively. The reply as to these requests was as follows:

"4-1002-2. D.

March 6, 1925.

J. G. Wray Company, 15 Dey Street, New York City.

Attention Mr. J. G. Wray

DEAR SIR: In answer to your two (2) letters of March 3, 1925, relative to the segregation figures for New Jersey, arrangements have been made whereby a statement will be furnished to you showing

the property, revenue and expense amounts which have been apportioned in the New Jersey case between exchange and toll, and between interstate and intrastate showing these by accounts and by dates, as prepared in the computation of the book cost, the reproduction cost and the value of the property of the company used in intrastate service, as set forth in the company's bill of complaint and the supporting affidavits.

In so far as percentages were used in the various allocations and apportionments involved in the above, these will also be furnished.

Yours very truly, (Signed) Frankland Briggs, Attorney in Charge of Commission Matters.

PHB:ATC."

[fol. 8] The data, memoranda, computations and studies relating to the segregation of the property, revenues and expenses of the plaintiff in the state of New Jersey between interstate and intrastate service are very voluminous and extensive in amount and were obtained by several different departments in the plaintiff's organization, and in order to comply with any request for access to such data, etc. it was necessary that such request be made with definiteness and certainty, so that such requests might be taken up with the proper departments; therefore, shortly prior to the time of the transmission of the above letters to Messrs. J. G. Wray & Company, I, in the course of an interview with Mr. G. W. Cummings, who is one of the associates of Messrs. Wray and Hill in their work in connection with this suit and the suits and proceedings of the plaintiff in the states of New York and New Jersey, indicated to him what would be made immediately available, and informed him that any part of such underlying data and memoranda as was referred to in general terms in the said requests would be furnished to J. G. Wray and Company if they would indicate with reasonable particularity just what was desired by them.

(Sd.) Paul H. Burns.

Subscribed and sworn to before me this 16th day of March, 1925. (Sd.) Lincoln Jones, Notary Public, Kings Co., No. 31. Cert. filed in N. Y. Co. No. 66. Kings Co. Register No 6033. N. Y. Co. Register No. 6060. (Seal.)

[fol. 9]

IN UNITED STATES DISTRICT COURT

[Title omitted]

AFFIDAVIT OF GEORGE W. WHITTEMORE IN REPLY TO ANSWERING
AFFIDAVIT OF CYRUS G. HILL ON DEPRECIATION

STATE OF NEW YORK,

County of New York, ss:

George W. Whittemore, being duly sworn, deposes and says:

I am the same George W. Whittemore who made the moving affidavit on depreciation verified January 29, 1925.

I have read the affidavit of Cyrus G. Hill, verified March 11, 1925, and have examined the charts and tables attached thereto as exhibits. The said affidavit contains many statements of fact which, in my opinion, are incorrect and untrue, in that they rest upon faulty estimates of average life expectancy and average net salvage expectancy as obtained by said affiant, Hill, and with which the plaintiff's managers and I disagree for reasons stated in my affidavit, verified January 29, 1925. Among the statements referred to by me are the following:

(1) Statement that the correct amount for the depreciation reserves as of December 31, 1924, was \$13,869,005 (p. 8).

(2) That the excess in said reserves on December 31, 1924, was \$5,294,621 (p. 8).

(3) That in less than ten years the plaintiff's depreciation reserve associated with the present property will be greater than the part of that property remaining to be retired, less salvage; and that in less than twenty years that reserve will have increased to an amount several hundred per cent greater than the property to be retired (p. 11).

(4) That when the present plant has been completely retired the plaintiff will have for the retirement of that plant, no longer existing, a reserve of over \$15,000,000 (p. 12).

The statements, together with the charts and tables attached as exhibits to said affidavits (pp. 34-38 inclusive) are based upon estimates of average life and salvage expectancy not borne out, in my opinion, by past actual experience, combined with present outlook for the plaintiff's property.

The affiant's statement on page 22 that the correctness of the average life expectancies for plant of the various classes, with the exception of central office equipment and buildings, may be considered as conceded by plaintiff, is untrue. The statement on page 23 that for twenty-one classes of plant the methods used for determining the average life and salvage from the plaintiff's experience have produced results which plaintiff believes to be correct, is also untrue. It is a [fol. 11] fact that as to twenty-one accounts the errors as to average

life and salvage in some accounts happen to produce results approximately equal to errors in the opposite direction in the remaining accounts, with the net result that as to the aggregate of these accounts, the errors practically balance one another. In my opinion, there are serious errors in Hill's rates for these accounts, considered individually.

Affiant on page 27 states that my estimate of salvage for subsidiary underground cable is not reliable for the reason that it is based on a relatively short period. The affiant's estimate is based on a longer period and a somewhat involved process of reasoning. Its principal fault, in my opinion, is that it includes the period of high prices and reflects the abnormal conditions due to the World War. Because of such distortion it is, I believe, far less reliable than an estimate based on recent conditions where no such distortion has occurred.

Similar objections apply to others of Hill's rates, for the coming years, including the rates discussed by him on pages 23 to 27 of his affidavit, in that such rates give entirely too much weight to salvage of war years. Hill says (p. 9) that average salvage of past ten years was considered by him the best indication of salvage percentages to be expected in the near future.

In view of the serious effect of the war in increasing demand, limiting supplies then available for telephone companies and in compelling reuse by such companies of removed plant items to an extent not warranted in more normal times, I regard Hill's opinion just stated as untenable and quite unsound.

[fol. 12] The affiant on page 32 states that no explanation has been given by me as to why a method which I claim gives too long a life for central office equipment should give too short a life when applied to buildings. I am unable to follow affiant's reasoning. The fact that a method produces two incorrect answers instead of one imposes no obligation known to me for the acceptance of such method. Rather, it confirms me in my opinion that affiant's method is unreliable, and hence, as fully explained in my affidavit of January 29, 1925, entirely unsuited for use either for buildings or for central office equipments.

I have also read the affidavits of J. G. Wray and am familiar therewith. With reference to the statements by said affiant Wray as to the use of property in intrastate and interstate service, it is clearly stated in my former affidavit verified January 29, 1925, that all figures therein relating to intrastate property only are based upon the method of apportionment set forth in the affidavit of Andrew Sangster, and all statements or insinuations of said Wray that my said affidavit implies "that the plaintiff's property is not, in great part, used interchangeably in both intra and interstate classes of telephone service" are wrong and misleading.

(Sd.) George W. Whittemore.

Subscribed and sworn to before me this 16th day of March, 1925. (Sd.) Lincoln Jones, Notary Public, Kings Co., No. 31. Cert. filed in N. Y. Co. No. 66. Kings Co. Register No. 6033. N. Y. Co. Register No. 6060. (Seal.

[Title omitted]

AFFIDAVIT OF ANDREW SANGSTER IN REPLY TO ANSWERING
AFFIDAVIT OF CYRUS G. HILL

STATE OF NEW YORK,

County of New York, ss:

Andrew Sangster, being duly sworn, deposes and says:

I am the Andrew Sangster that made two affidavits verified on the 29th day of January, 1925, filed by the plaintiff as part of the moving papers in this suit. I have read the affidavit of Cyrus G. Hill on depreciation verified the 11th day of March, 1924 [sic], and am familiar with the same. The affiant on page 17 of his affidavit refers to a statement in my affidavit on depreciation accounting verified the 29th day of January, 1925, that "the order of the Board would in effect require the plaintiff to charge against the credit to the reserve for depreciation something entirely different; namely, an [fol. 14] estimated amount of a theoretical excess in the reserve for depreciation", and says that such statement is erroneous and can only result from an entire misinterpretation of the defendants' order in that the order does not require charges to be made to the reserves. It is true that said order does not accomplish this by requiring the deficiency of earnings to be entered directly as a charge to the reserve and it is not so stated in my former affidavit, the statement being that the order "in effect" required such charges to be made. That the defendants did intend to do by indirection what they did not do directly is shown by the following quotation from the defendants' decision:

The Board finds that the Company has charged to expenses and credited to reserves at least \$1,750,000 as above indicated, which amount is in excess of the amount warranted, and therefore, future charges computed at the depreciation rates hereinafter fixed should be decreased sufficiently to absorb this overcharge.

"From the amounts ascertained by the application of the depreciation percentages hereinafter provided, on and after January 1st, 1925, the Board will direct the company to deduct such amount of depreciation expenses as will permit the resultant net telephone earnings to equal the fair return as herein found; this procedure to be followed until the excess credit of \$1,750,000 above referred to is absorbed." (Bill p. 86).

The above quotation clearly demonstrates that the intention of the Board was to reduce an alleged excess credit to the reserve balance accumulated in the past by limiting the future additions to such reserve to an amount less than the currently accruing expense of depreciation.

[fol. 15] In my former affidavit verified the 29th day of January, 1925, I pointed out that the Uniform System of Accounts provided

in its Account 413 for realized depreciation not covered by reserves in order that the expense of depreciation currently accruing during any month or year should not be distorted by reason of losses arising from retirement of tangible fixed capital which had not theretofore been fully provided for in a depreciation reserve.

The affiant on page 17 states that in my said former affidavit I argued from the fact that "the Interstate Commerce Commission evidently intended the depreciation reserve accumulated after January 1, 1913 to be utilized to meet that part of the realized depreciation which had accrued since January 1, 1913." This is followed by statements of the affiant which are based on a misunderstanding of the provisions of the Uniform System of Accounts with respect to realized depreciation accrued prior to January 1, 1913, and the conclusion is finally drawn by affiant that plaintiff has not complied with the rules of the Interstate Commerce Commission, particularly with respect to Account 413. It is not a fact as inferred by affiant that said Interstate Commerce Commission did intend Account 413 (depreciation Not Covered by Reserves) to be utilized to meet that part of the realized depreciation which had accrued prior to January 1, 1913. There was no intention on the part of said Interstate Commerce Commission to make a distinction between reserves created prior to and since January 1, 1913, and Account 413 makes no such distinction but does provide that there should be charged to that account the realized depreciation on tangible fixed [fol. 16] capital retired, if such depreciation had not been provided for through a depreciation reserve.

The plaintiff has since the early days of its existence continuously maintained a depreciation reserve and has charged to said reserve retirements of fixed capital made during that period; it has consequently had relatively small occasion to make charges to Account 413 but has done so in appropriate cases. In my opinion the plaintiff has, in making charges and credits to its reserve for depreciation and to other accounts referred to by said Hill, including Account 413, complied in all respects with the Uniform System of Accounts prescribed by said Interstate Commerce Commission.

I desire to point out that nowhere in his affidavit has the said Hill denied or refuted the fact that the amount to be charged to operating expenses in any month or year as the expense of depreciation is the expense currently accruing during such month or year, or the further fact that the order of the defendants if enforced would compel plaintiff actually to charge to such expense less than said currently accruing amount, thereby violating the provision of said Uniform System of Accounts.

(Sd.) Andrew Sangster.

Subscribed and sworn to before me this 16th day of March, 1925. (Sd.) Lincoln Jones, Notary Public, Kings Co., No. 31. Cert. filed in N. Y. Co. No. 66. Kings Co. Register No. 6033. N. Y. Co. Register No. 6060. (Seal.)

[fol. 17] IN UNITED STATES DISTRICT COURT

[Title omitted]

AFFIDAVIT OF HENRY C. CARPENTER IN REPLY TO ANSWERING AFFIDAVIT OF JAMES G. WRAY

STATE OF NEW YORK,

County of New York, ss:

Henry C. Carpenter, being duly sworn, deposes and says:

I am the General Manager of the plaintiff and the same Henry C. Carpenter who made the moving affidavit herein verified January 29, 1925. I have read the affidavit of James G. Wray verified March 13, 1925, relating to my said moving affidavit.

The statement in said Wray affidavit (p. 45) that my former affidavit "incorrectly states the way in which new capital and facilities to take care of growth are provided" is untrue. The statements made by me in reference to those subjects in my said affidavit are in all [fol. 18] respects true and correct. Additional plant, facilities and equipment are provided in varying quantities according to the demand and expected demand for additional telephone service.

The statements made by said Wray on pages 45 and 46 of his affidavit to the effect that substantial amounts of new capital are "contributed by the rate payers through charges for depreciation" are incorrect and untrue. As a matter of fact, the telephone subscribers of the plaintiff have never contributed to it anything on account of new capital or on account of any operating expenses. The only payments which have ever been made or are ever made to the plaintiff by its subscribers are payments at lawful rates made by them on account of and in payment for services and facilities furnished to them by plaintiff, and such amounts as have been appropriated by the plaintiff to provide for its expense on account of depreciation, or to provide for its other expenses, have been so appropriated by it out of its own moneys earned by it and paid to it as aforesaid.

The ascertainment of the average cost of the intrastate property of the plaintiff in 1925 as stated on page 13 of my said former affidavit was made by me on the methods and bases shown in the moving affidavit of Andrew Sangster, verified January 29, 1925. The methods and bases of apportionment between intrastate and interstate property adopted and used by the plaintiff in this suit are well known to the said Wray, as such methods and bases of apportionment are the same as were adopted and used in the suit of the plaintiff which is now pending in the United States District Court in the [fol. 19] Southern District of New York, in which latter suit the said Wray is also acting as an expert (see Wray affidavit, p. 44, fol. 10). As the said Wray recognizes, the allocations and apportionments involved in making an estimate of the purely intrastate property are extremely intricate and complicated and necessitate the study and examination of voluminous data and information obtained from many different departments in the plaintiff's organization. The re-

quest of said Wray to examine such data and information used in making such segregation of intrastate property, revenues and expenses has not been refused, as more fully appears from the annexed replying affidavits made by Frankland Briggs and Paul H. Burns.

The said Wray at page 47 of his affidavit states that "I am of the opinion that the average book costs of its property (plaintiff's total property in New Jersey) in 1925, including interest during construction and working capital, and excluding construction work in progress, will be \$86,400,000." The plaintiff's figure of such average cost of said property in 1925 is \$88,503,107.51, as stated on page 14 of my said affidavit, verified January 29, 1925. The average cost of construction work in progress which said Wray excludes without justification will amount to more than the \$2,000,000 difference between his figures and mine. The said construction work in progress is paid for with dollars which are as irrevocably committed to the enterprise and as clearly entitled to a return as the dollars invested in plant which is actually rendering service. The exclusion of the [fol. 20] construction work in progress rests upon an unsound distinction between property in course of construction and the finished product. From the standpoint of the investor and the owner of the property there is and can be no such distinction.

(Sd.) Henry C. Carpenter.

Subscribed and sworn to before me this 16th day of March, 1925. (Sd.) Lincoln Jones, Notary Public, Kings Co., No. 31. Cert. filed in N. Y. Co. No. 66. Kings Co. Register No. 6033. N. Y. Co. Register No. 6060. (Seal.)

[fol. 21] THE UNITED STATES DISTRICT COURT

[Title omitted]

AFFIDAVIT OF HARLAND A. TRAX IN REPLY TO ANSWERING AFFIDAVITS OF HILL AND WRAY

STATE OF NEW YORK,
County of New York, ss:

Harland A. Trax, being duly sworn, deposes and says:

I am the Harland A. Trax who made an affidavit verified January 29, 1925, filed by plaintiff as part of the moving papers in this suit.

I am familiar with the affidavit of Cyrus G. Hill verified March 11, 1924, [sic], and the several affidavits of James G. Wray verified March 13, 1925, filed by defendants in this suit. The figures used by affiant Hill on page 7 of his affidavit are incorrect and erroneous in the following respects: The figure purporting to show the annual expense of depreciation for the year 1924 obtained by applying the depreciation rates set forth on page 6 of said affidavit is \$2,678,386. [fol. 22] This figure purports to show the total amounts of depre-

ciation expense handled through the charges to Accounts 608 and 340 and in addition thereto the charges to depreciation handled through the clearing accounts 701-707 inclusive. It will be noted that on page 63 affiant Wray purports to show as the expense of depreciation and amortization for said year 1924 the amount \$2,820,788, which amount does not include the depreciation expense handled through said clearing accounts. The figure of said Hill should be higher than that used by said Wray and the inconsistency is apparent. Said Hill's figure if properly computed would have been approximately \$2,970,000. Mr. Hill states that for the year 1924 the plaintiff set aside, to cover depreciation of its property in New Jersey, the following amount—\$3,762,612. This figure is incorrect, the correct figure being \$3,621,000, as shown by plaintiff's books. The errors in the foregoing figures consequently affect a third figure used on said page 7 of \$1,084,226, which is the difference between his two above figures. Using correct figures instead of the erroneous figures used by said Hill this difference would be approximately \$650,000.

I have examined the tables in the affidavit of said Wray appearing on pages 61-4 inclusive purporting to show income which would have been or would be earned by plaintiff in the years 1922-1925 inclusive under the rates as filed by the plaintiff on March 6, 1924. In these tables said Wray computes depreciation expense on the rates prescribed by the defendants herein in the order complained of. Said Wray also fails to take into account certain adjustments in various expense items which would result from the increase in gross [fol. 23] revenues, the effect being to increase substantially the percentages purporting to be the return upon the cost and value of plaintiff's property appearing on said tables.

I have read the affidavit of Andrew Sangster verified March 16, 1925, on depreciation accounting and concur with the statements and opinions expressed therein. It is my opinion that plaintiff has, in making credits and charges to its reserve accounts and in making charges to Account 413 (Depreciation Not Covered by Reserves), in all respects complied with the Uniform System of Accounts prescribed by the Interstate Commerce Commission.

Said Wray on page 69 of his affidavit states that the plaintiff has presented no figures to show that it is receiving a fair and reasonable share of the revenues from long distance service handled over its wires. I am familiar with studies and computations that have been made under my direction which show that the return earned by plaintiff on its property devoted to long distance service is substantially higher than the return on property devoted to plaintiff's other services.

(Sd.) Harland A. Trax.

Subscribed and sworn to before me this 16th day of March, 1925. (Sd.) Lincoln Jones, Notary Public, Kings Co., No. 31. Cert. Filed in N. Y. Co., No. 66. Kings Co. Register No. 6033. N. Y. Co. Register No. 6060. (Seal.)

[fol. 24]

IN UNITED STATES DISTRICT COURT

[Title omitted]

AFFIDAVIT OF ANDREW SANGSTER IN REPLY TO WRAY AFFIDAVIT OF
SEPARATION

STATE OF NEW YORK,

County of New York, ss:

Andrew Sangster, being duly sworn, deposes and says:

I am the Andrew Sangster who made the moving affidavit filed by plaintiff in this suit on separation of property, revenues and expenses between intrastate and interstate verified the 29th day of January, 1925.

I have read the affidavit of James G. Wray in answer thereto, appearing on page 65 et seq. of defendants' affidavits.

Affiant Wray on page 66 enumerates certain classes of service furnished by plaintiff in addition to its ordinary exchange and toll tele- [fol. 25] phone service and states that the property and business of plaintiff are not limited alone to intrastate and interstate telephone service as alleged by me. It is true that my former affidavit does not specify all of the subsidiary classes of service referred to by said Wray but all of such business is covered by the accounts prescribed by the Uniform System of Accounts and a complete list of said accounts is set forth in my former affidavit showing the basis of apportionment of each account between the interstate and intrastate services furnished by plaintiff. This apportionment covers, therefore, all of plaintiff's property in the State of New Jersey as well as all of the revenues derived from the use of such property and all the expenses incurred in rendering the service.

Affiant Wray also states (p.66) that plaintiff leases a very large proportion of its property, amounting to many millions of dollars, to the American Telephone and Telegraph Company, and further, that all the wires and other facilities within the so-called "33-mile area" used for the long distance and other services furnished by the American Telephone and Telegraph Company are so leased. In the apportionment of the property, revenues and expenses of the plaintiff referred to in my former affidavit such property of plaintiff in the 33-mile area leased to the American Telephone and Telegraph Company was included in the apportionment of the plaintiff's property between its interstate and intrastate services.

Affiant Wray also states on page 67 that my former affidavit fails to show the exact apportionment made by me or the detailed methods [fol. 26] used in such apportionment and alleges that the results of segregation of intrastate property, revenues and expenses will differ greatly depending upon the interpretation of what is meant by "extent of the use." Said Wray further states that he is familiar with the method used by me in making a segregation for plaintiff of its intrastate telephone business in the State of New York and knows

that "said method was unsound and attributed to the Intrastate business more property and larger expenses than was just and reasonable or in accord with the facts." The basis of apportionment set forth in my former affidavit in this suit is the same basis used by me in the two suits brought by this plaintiff in the District Court of the United States for the Southern District of New York, in which suits affidavits similar to my former affidavit in this suit were made by me. Said Wray was employed as expert by defendants in those suits and made affidavits criticising and attacking my apportionment for reasons similar to those now given by him. The first of these suits was taken to the Supreme Court of the United States and in neither suit was the attack upon my method of apportionment sustained by the Court. In the second suit the statutory court in its opinion, reported in 300 Fed. Rep. at page 827, said:

"We see no reason to doubt that the various pro ratings on interstate business have been properly done."

Nowhere in said Wray's affidavit or in any other of defendants' answering affidavits in this suit is any other method of separation suggested. It is my opinion that no other proper method of separation [fols. 27 & 28] as between intrastate and interstate business would produce a result which would show a substantially higher percentage of return on plaintiff's property devoted to intrastate business.

(Sd.) Andrew Sangster.

Subscribed and sworn to before me this 16th day of March, 1925. (Sd.) Lincoln Jones, Notary Public, Kings Co., No. 31. Cert. filed in N. Y. Co. No. 66. Kings Co. Register No. 6033. N. Y. Co. Register No. 6060. (Seal.)

[fol. 29] [File endorsement omitted.]

1-
e
h
n
e
s
y
s
r
s
r
y
t

(20)

FILED

DEC 21 1925

WM. R. STANSBURY
CLERK

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM—1925

No. [REDACTED] 567

BOARD OF PUBLIC UTILITY COMMISSIONERS
and HARRY V. OSBORNE, JOSEPH V. AUTEN-
REITH and FREDERICK GNICHTEL, constituting
said board

Defendants-Appellants

against

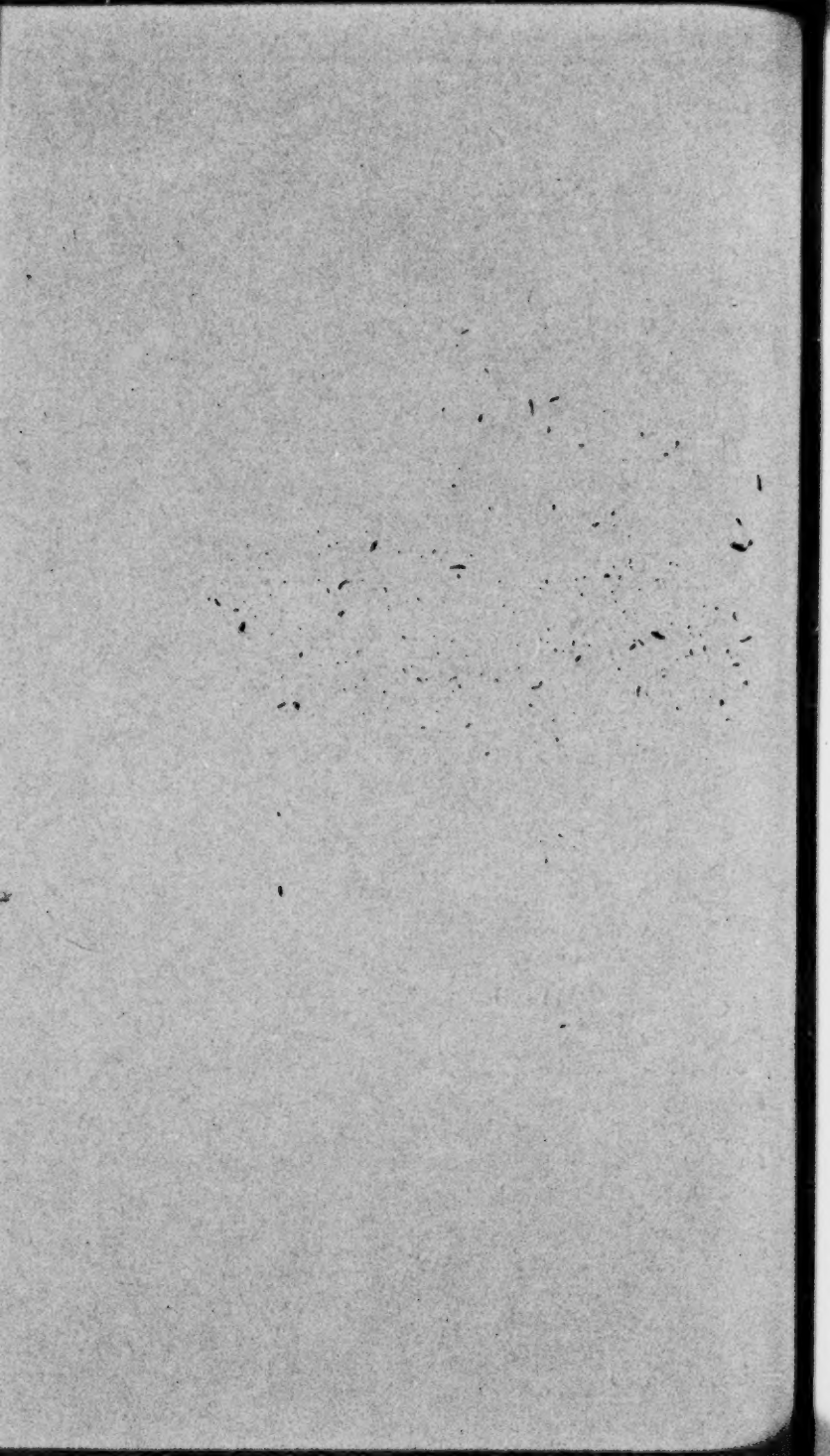
NEW YORK TELEPHONE COMPANY

Complainant-Appellee

BRIEF FOR APPELLANTS

*Not the property of the Co-
-servation of Landmarks Society*
THOMAS BROWN

Counsel for Appellants



SUBJECT INDEX.

Statements under Rule 25	PAGE 1-5
--------------------------------	-------------

ARGUMENT.

I. The appellant Board has the power of the State to fix just and reasonable rates for service by utilities and to fix proper depreciation charges..	5
II. Depreciation expense is a charge made against earnings periodically to care for depreciation of the utility's property not covered by current repairs.	
Depreciation reserve is the fund accumulated from such depreciation charges	7
III. The Court erred in holding that the excess in the depreciation reserve was the absolute and unqualified property of the appellee	11
IV. The Court erred in holding that the appellants were estopped from inquiring whether there was an excess in the depreciation reserve; and finding such excess, from requiring that such excess be absorbed	18

STATUTES AND CASES CITED.

In re Consumers Co., P. U. R., 1923, A420	15
In re Eaton Rapids Co., P. U. R., 1922, D94	15
Georgia Ry. & Power Co. v. Railroad Commission, P. U. R., 1925, A594	14
Georgia Ry. & Power Co. v. Railroad Commission, 262 U. S., 625	2
Jackson v. Cravens, 238 Fed., 117	2

	PAGE
Knoxville <i>v.</i> Knoxville Water Co., 212 U. S., 1	9, 11, 14
Louisiana R. R. Commission <i>v.</i> Cumberland Telephone & Telegraph Co.	12, 14
Louisville, etc., R. Co. <i>v.</i> Garrett, 231 U. S., 298	2
New Jersey Public Utilities Act	2, 5, 6, 10
Newton <i>v.</i> Consolidated Gas Co., 258 U. S., 165	14
New York Telephone Co. <i>v.</i> Prendergast, 262 U. S., 43	18
Prendergast <i>v.</i> N. Y. Telephone Co., 262 U. S., 43	2
In re So. California Edison Co., P. U. R., 1924, 1	16
In re Thompson, P. U. R., 1922, A558	15
U. S. Judicial Code, Section 266	2
In re Utica Gas Co., P. U. R., 1922, A558	16

Supreme Court of the United States

OCTOBER TERM, 1925.

BOARD OF PUBLIC UTILITY COMMISSIONERS
and HARRY V. OSBORNE, JOSEPH F.
AUTENRIETH and FREDERICK GNICHTEL,
constituting said board,

Defendants-Appellants,

against

NEW YORK TELEPHONE COMPANY,
Complainant-Appellee.

BRIEF FOR APPELLANTS.

The opinion delivered by the Court below is officially reported in 5 Fed. 2nd Ser. page 245.

The judgment to be reviewed is an interlocutory injunction order of the United States District Court dated May 12, 1925 (Record, p. 240), upon which a writ of injunction dated May 23, 1925 (Record, p. 242) was issued against the appellants.

The rulings made in the lower Court which are claimed to be erroneous and which are relied upon as the basis of this Court's jurisdiction are (1) the ruling that the Appellant Board in a proceeding to determine reasonable rates for service of a public utility is precluded from inquiring into the excessive charges made in the past by such utility for depreciation (Record, p. 238); (2) the ruling that even if the Appellant Board in such proceeding is not estopped from inquiring into the excessive de-

preciation reserve accumulated by such utility, said Board, nevertheless, cannot fix lower depreciation charges for the appellee than what are normally required, until such time as such excess accumulated in the past shall be absorbed in future earnings (Record, pp. 238, 239); (3) the ruling that such excess in the amount accumulated by the appellee in the depreciation reserve fund is the absolute and unqualified property of the appellee (Record, pp. 238, 239).

The statutory provisions under which the jurisdiction of this Court is invoked are found in Section 266 of the Judicial Code (Act of March 3, 1911, Ch. 231; 36 Stat. L. 1087) which provides that an appeal may be taken to this Court from an order of a lower court granting an interlocutory injunction restraining the enforcement of an order made by a State Board—the Board of Public Utility Commissioners of New Jersey—pursuant to a statute of that State (Chap. 195, Laws 1911, New Jersey).

The cases sustaining this Court's jurisdiction are numerous. *Louisville, etc., R. Co. v. Garrett*, 231 U. S., 298; *Prendergast v. N. Y. Telephone Co.*, 262 U. S., 43; *Georgia Railway & Power Co. v. Railroad Commission*, 262 U. S., 625. The appeal in cases like the instant one must be taken direct to this Court. (*Jackson v. Cravens*, 238 Fed., 117.)

Statement of the Case.

The appellants are an administrative board of the State of New Jersey possessing the rate regulating powers of that State over public utilities by virtue of Chapter 195 of the Laws of 1911 of New Jersey. Section 16 (d) of that act gives the Appellant Board power to require every utility to file with it schedules of rates, and the Board's procedure requires every utility which proposes to change its rates to file a schedule of such changed rates with the Board.

The appeal herein was taken by the appellants for the purpose of reviewing the order of the District Court of the United States for the District of New Jersey, consisting of three Judges in accordance with Section 266 of the Judicial Code, made on May 12, 1925, and entered in the office of the Clerk of the District Court aforesaid on said date, which order granted an interlocutory injunction during the pendency of this cause, restraining the appellants from attempting to compel the appellee to observe or keep in force the rates for telephone service required to be continued in effect by the order of December 31, 1924, of the Appellant Board of Public Utility Commissioners, or otherwise to observe or comply with any of the provisions of said order (Record, p. 240).

The said order of December 31, 1924, made by the Appellant Board (Record, pp. 16, 18) was the result of an investigation made by it as to the reasonableness of certain rates increasing the then existing rates which the appellee proposed to put into effect in that part of the State of New Jersey in which it operates. The order in question prevented the imposition of the proposed rates at that time, principally upon the ground that the depreciation reserve fund which the appellee had accumulated was greatly in excess of what was adequate, and that the appellee was setting aside from its earnings annually for such reserve an excessive amount. The Board fixed what it considered to be proper depreciation rates. In view, however, of the excess which appellee had accumulated in the reserve fund for depreciation (Record, pp. 49, 50) the Board ordered that a reduction be made by the appellee of the amounts from revenues which it deemed ordinarily proper for that purpose until such excess should be absorbed. It permitted the appellee, however, to apply the difference between such temporary allow-

ance for depreciation and that which the Board deemed ordinarily just, to be applied to the making up of a fair return on the fair value of the appellee's property. That is to say, the Board found the total excess in the reserve fund to be \$4,984,009, and the normal amount required for annual depreciation \$2,678,386 (Record, p. 50), but did not allow the company after January 1, 1925, to deduct the full latter sum and ordered it to use enough of said \$2,678,386 to bring the return on the value of its property up to 7.53 per cent. until such time as it should thus have absorbed \$4,750,000 of such excess in the reserve fund (Record, pp. 17, 61). This action of the Appellant Board was held to be confiscatory of the appellee's property by the Court below in and by the order appealed from herein, and the appellee was by said order of the Court below permitted to collect the increased rates from its customers in New Jersey, numbering about 250,000, during the pendency of this suit. There is no question here as to the fairness of the valuation of the appellee's property which was made by the Board nor of the adequacy of the rate of return, viz; 7.53 per cent. which the Board allowed, nor of the fact that there is a surplus exceeding \$4,750,000 in the appellee's depreciation reserve.

The Court decided the case as above stated upon the sole ground that the action of the Appellant Board with reference to current depreciation rates and the accumulated depreciation reserve was illegal (Record, p. 238).

The Court found that such action of the Board presented two questions which may be best expressed in the Court's own language (Record, p. 238):

"First, whether the Board may now be heard to say with retroactive effect that the charges made in the past by the plaintiff were excessive; and,

second, even if it be conceded that they were, whether that fact would confer upon the defendant the right and power to base an order with respect to future rates upon a result or rate of return obtained by allowing to the plaintiff as a depreciation expense a sum less than the Board itself finds to be the actual, normal, currently accruing depreciation."

Deciding both of these questions in the negative the Court held that the Board's action was confiscatory of the company's property and did not permit it really to earn the fair return of 7.53 per cent.

Preliminarily to the discussion of the propriety of the Court's decision with reference to these two questions we shall set forth in Point I, *infra*, the power of the Board to regulate rates and in Point II, the nature and character of depreciation expense and depreciation reserve.

The assignments, therefore that are intended to be urged are those numbered 4, 5, 6, 7, 8 and 9 which allege error in the Courts ruling on the questions of the Board's power with reference to current depreciation rates and the depreciation reserve fund of the appellee (Record, p. 245).

POINT I.

The appellant Board has the power of the State to fix just and reasonable rates for service by utilities and to fix proper depreciation charges.

Chapter 195 of the Laws of New Jersey, Section 16 (c) provides that the Board shall have power after hearing to fix just and reasonable rates for any public utility.

Section 17 (h) of that Act provides that when any public utility shall increase any existing rates the Board shall have power to hear and determine whether such increase

is just and reasonable and the burden of proof to show that the increase is just and reasonable shall be upon the public utility making the same.

Section 17 (f) of the Act authorizes the Board

"to require every public utility to carry, whenever in the judgment of the Board it may reasonably be required, for the protection of stockholders, bondholders or creditors, a proper and adequate depreciation account in accordance with such rules, regulations and forms of account as the Board may prescribe.

"The Board shall from time to time ascertain and determine, and by order in writing after hearing fix proper and adequate rates of depreciation of the property of each public utility in accordance with such regulations or classifications, which rates shall be sufficient to provide the amounts required over and above the expense of maintenance to keep such property in a state of efficiency corresponding to the progress of the industry. Each public utility shall conform its depreciation accounts to the rates so ascertained, determined and fixed, and shall set aside the moneys so provided for out of earnings and carry the same in a depreciation fund. The income from investments of money in such fund shall likewise be carried in such fund. This fund shall not be expended otherwise than for depreciation, improvements, new constructions, extensions or additions to the property of such public utility."

POINT II.

Depreciation expense is a charge made against earnings periodically to care for depreciation of the utility's property not covered by current repairs.

Depreciation reserve is the fund accumulated from such depreciation charges.

Depreciation—Its Purpose and Use.

The Interstate Commerce Commission's instructions pertaining to the annual allowances for depreciation in "Uniform System of Accounts for Telephone Companies," define depreciation expense as follows:

"(a) The losses suffered through the current lessening in value of tangible property from wear and tear (not covered by current repairs).

"(b) Obsolescence or inadequacy resulting from age, physical change, or supersession by reason of new inventions and discoveries, changes in popular demand, or public requirements, and

"(c) Losses suffered through destruction of property by extraordinary casualties."

The Interstate Commerce Commission rules further provide that:

"The estimate for depreciation of physical property should take into account:

"(a) The gradual deterioration and ultimate retirement of units of property which may be satisfactorily individualized, such as buildings, machines, valuable instruments, etc., to the end that by the time such units of property go out of service there shall have been accumulated a reserve equal to the original money cost of such property plus

expenses incident to retirement less the value of any salvage.

“(b) The depreciation accruing in property which cannot be readily individualized, such as pole lines, wires, cables, or other continuous structures, where expenditures for repairs or replacements of individual parts ordinarily are not actually made until the later years of the life in service of such property, and when made may, therefore, be classed as extraordinary repairs.”

Inasmuch as the company's property deteriorates, wears out and is consumed through use and the ravages of time it becomes necessary for the company to provide for this through appropriate charges in its operating expenses to the end that it may keep its property intact and continue to furnish service uninterruptedly.

Depreciation charges (which, computed on an average basis, are amounts the company estimates it will ultimately need to replace its investment in property units when they are finally retired) are therefore included in the operating expenses and corresponding credits are made to a depreciation reserve.

When units of property become worn out or used up and are actually retired the original cost of each property unit is written off from the fixed capital account and a corresponding debit (less any net salvage realized) is made against the depreciation reserve.

The depreciation reserve then is the accumulation of depreciation charges (charged in operating expenses) as yet not actually used for the purpose, but intended to ultimately reimburse the company for its investment in property units as those units are used up and actually retired.

✓ The depreciation reserve is actually invested in the

company's property and will always be available for such use so long as the current depreciation charges included by the company in its expenses as depreciation expense and credited to the depreciation reserve, are not less than the current debits to the depreciation reserve because of property units retired.

The accrued depreciation in the company's property may or may not be equal to the depreciation reserve, for the depreciation in the property is the result of wear, use, the elements, obsolescence, inadequacy, etc. The depreciation reserve depends upon the financial provision which the company has made for the ultimate replacement of its investment in plant units when and as they are retired and is founded wholly on opinion estimates as to the lives of plant units and the salvage to be realized from plant units to be retired many years in the future.

In *Knoxville v. Knoxville Water Company*, 212 U. S., 1, Mr. Justice Moody said:

"Before coming to the question of profit at all the company is entitled to earn a sufficient sum annually to provide not only for current repairs, but for making good the depreciation and replacing the property when they come to the end of their life. The company is not bound to see its property gradually waste, without making provision out of earnings for its replacement. It is entitled to see that from earnings the value of the property invested is kept unimpaired, so that, at the end of any given term of years, the original investment remains as it was at the beginning. It is not only the right of the company to make such a provision, but it is its duty to its bond and stockholders, and in the case of a public service corporation, at least, its plain duty to the public."

This quotation makes it clear that the allowance in ex-

pense for depreciation is required in the interest of the bond and stockholders on the one hand and the public, concerned with continuously adequate and proper service, on the other hand.

It likewise makes it clear that the measure of allowance is the sum required to assure that "the original investment remains as it was at the beginning," and that its purpose is "the making good the depreciation" and replacing the units of property "when they come to the end of their life."

It also makes it clear that the allowance cannot be considered profit for it is taken by the utility before and in addition to profit for the specific purpose above indicated.

It follows that the depreciation reserve is built up not merely in protection of the integrity of the investment of the bond and stockholders but in the protection of the interest of the public in continuously adequate service as well.

This reserve is the property of the company only in the sense that the legal title thereto rests in it, but its right of property therein is qualified by the public interest in protection of which the reserve is built up.

The Public Utility Act of New Jersey (P. L. 1911, Chapt. 195) in Section 17 (f) recognizes the qualified nature of the ownership of the reserve, in that it provides that the reserve, "shall not be expended otherwise than for depreciation, improvements, new constructions, extensions or additions to the property of such public utility" and that the income from investments of moneys in the reserve shall be carried to the credit thereof.

POINT III.

The Court erred in holding that the excess in the depreciation reserve was the absolute and unqualified property of the appellee.

This is assignment of error Number 8 (Record, p. 245).

The lower Court's finding on the first of the two propositions quoted page 4, *supra*, forming the basis of its decision, was that the Board could not inquire into the surplus in the appellee's depreciation reserve because such surplus is to be considered as profit and is now part of the company's property.

We maintain that the excess in the depreciation reserve is not profit and is not the property of the company to do with as it may, but having been prematurely and unnecessarily taken from the rate payers the Board may give the rate payers the benefit of such excess when fixing rates for the future.

The stockholders and bondholders having been adequately protected by placing in the depreciation reserve all the money that is needed for that purpose, the balance—that is—the surplus of \$1,750,000 is in the nature of a trust fund for the benefit of the public from whom it has been prematurely taken.

The quotation from *Knoxville v. Knoxville Water Co.*, *supra*, indicates that the reserve is for the benefit of the public as well as the company and that all that the company is entitled to is that its original investment shall remain unimpaired. The company's investment not only remains unimpaired but it has the above surplus in its reserve fund. The Board did not take this surplus away from the company but directed it to refrain from adding to it until the depreciation reserve requirements of the property should come to equal the depreciation reserve

actually accumulated. The Court's opinion refers to it as "profit," acquired by the company. It is not profit because as Justice Moody said in the Knoxville case *supra* it is something set aside before and in addition to any profit.

If it were profit it could be added to capital or disbursed to the stockholders in dividends but it cannot be so used, nor is it to be considered as part of the property of the company which the latter absolutely owns.

In *Louisiana R. R. Commission v. Cumberland Tel. & Tel. Co.*, 212 U. S., 410, this Court held that:

If a public service corporation raises more money in a particular year than required for actual depreciation it cannot carry the excess to capital for the purpose of estimating the amount on which it is entitled to pay dividends in determining whether a rate is unconstitutional as confiscatory, and the onus of showing that this has not been done is on complainant where the books show that such an excess has been collected.

The Court below in that case had enjoined the enforcement of certain rates prescribed by the railroad commission. Such rates superseded and set aside other rates which had formerly been established by the same commission. Included in the investment of the company was an amount set aside for the depreciation reserve fund. The case was similar to the one at bar.

The Court says, page 424:

"It was obligatory upon the complainant [the Telephone Company] to show that no part of the money raised to pay for depreciation was added to capital upon which a return was to be made to stockholders in the way of dividends for the future. It certainly was not proper for complainant to take the money, or any portion of it, which it received as a result of the rates under which it

was operating and so to use it, or any part of it as to permit the company to add it to its capital account, upon which it was paying dividends to its stockholders. If that were allowable it would be collecting money to pay for depreciation of the property, and having collected it, to use it in another way, upon which the complainant would obtain a return and distribute it to its stockholders. That it was right to raise more money to pay for depreciation than was actually disbursed for the particular year there can be no doubt, for a reserve is necessary in any business of this kind, and so it might accumulate; but to raise more money than enough for the purpose and place the balance to the credit of capital upon which to pay dividends cannot be proper treatment."

It must be remembered that in the instant case the Court assumed that the company was getting a fair return on its property during the years that the excess in the depreciation reserve fund was being accumulated. This excess was accumulated unnecessarily, if not improperly, and at the expense of the rate payers. Having been taken from the rate payers for a purpose for which it was not needed the Board had the right to say as it did to the company:

"You ask an increase in rates. You have taken too much in depreciation charges annually from the revenues received by you from the public, so that now you have \$4,750,000 more set aside in your reserve for the depreciation of your plant than is necessary. While we permit you to keep that sum, we do not intend to allow you to take it twice and therefore we direct that hereafter you shall not set aside for depreciation annually the amount which you would have the right to appropriate for that purpose if you had not already taken too much, but shall use the sum you

should ordinarily set aside for such depreciation in paying to yourself instead, a fair return on your capital investment until in this manner you have absorbed the amount of the excess in your depreciation reserve, to wit, \$4,750,000."

The appellee cited in its brief below and the Court relied on *Newton v. Consolidated Gas Co.*, 258 U. S., 165, as the basis for its opinion that the excess in the depreciation reserve fund is the property of the appellee (Rec., p. 238, fol. 244).

That case does not apply. In that case the contention was made that because the public utility had in former years made large profits which had been distributed to its stockholders it should forego a reasonable return for some time in the future. The case at bar is different, however, first because as we have shown, the excess in the depreciation reserve fund has not been distributed and cannot legally be distributed to stockholders; is not the property of the company and is affected with a public interest. *Knoxville v. Knoxville Water Co.*, *supra*. *Louisiana Commission v. Cumberland Telephone & Telegraph Co.*, *supra*. The case at bar differs from *Newton Consolidated Gas Co.*, secondly because the appellee is not asked to forego a reasonable return, but in fact, is allowed to make a reasonable return—7.53 per cent.—by the Board's decision.

The action of the Board is in accordance with the general practice regarding the treatment of excessive reserve for depreciation.

In *Georgia Ry. & Pr. Co. v. Railroad Com.*, P. U. R. 1925, A, page 594, a Federal case not officially reported, the Master (after quoting the authorities) says:

"To allow a reserve which, during the estimated life of the plant would amount to more than the

original investment, would be to give the utility, out of rates collected from the public, not only a reserve, sufficient to keep its investment unimpaired, 'so that at the end * * * the original investment remains as it was at the beginning,' but additional capital also. The utility should be allowed reserve for replacement sufficient to keep the investment unimpaired and in addition, a fair return upon the present value of the property, but the public should not be required to build up, in the form of maintenance reserve, additional capital for the utility. * * * To allow reserve on this basis would, to the extent of the additional capital furnished by the public, amount to the confiscation of the property of the users of gas."

In *Re Thompson*, P. U. R. 1922, A, 558, a case before the Illinois Commerce Commission on application for increase in rates, the Commission found that the applicant had accumulated a large amount of what was called a renewal fund of the company's. This amount, the Commission found, was sufficient for present purposes of the fund and ordered that no further additions or accumulations therein should be made until the further order of the Commission.

In *Re Eaton Rapids*, P. U. R. 1922, D, 94, a case before the Michigan Public Utilities Commission on application for increase in rates. The Commission determined that the utility should earn for depreciation requirements considerably less than it had during some time previous.

In *Re Consumers Company*, P. U. R. 1923, A, 430, the Idaho Public Utilities Commission determined that the depreciation reserve is over accrued, that is to say, the amounts already paid in by the customers of the company were larger than were necessary, so that for the next few years, at least, there was no reason why further earnings should be exacted for the purpose of increasing

a reserve which was already too large, therefore, no amount for depreciation expenses was included in the rate applied for.

In *Re Southern California Edison Company*, P. U. R. 1924, C1, the California Commission held that the reserve fund should be accounted for so that the Commission could make adjustments.

In *Re Utica Gas Company*, P. U. R. 1922, A, 558, the New York Commission found the company had accumulated an excessive depreciation reserve fund and ordered it not to make any further accumulation for this purpose.

The second of the two questions upon which the Court made its decision turn was: Conceding that the Board has the power to determine that the depreciation reserve is excessive, would the Board in view of such excess have the right in fixing future rates to allow appellee as a depreciation expense a sum less than the Board finds the normal current depreciation to be? We have heretofore necessarily considered this question. We have shown that it is neither "profit" nor "property" of the appellee and that having been taken prematurely and unnecessarily from the public it is held in the character of a trust fund for the benefit of the public. The Board had the right to prevent the taking of any additional depreciation until the excess should be absorbed, and it could require that the sum ordinarily needed for depreciation should be used in another way, *i. e.*, to make up a return of 7.53 per cent. upon the value of the appellee's property.

Taking a concrete example, suppose the appellee installed in 1914 a pole costing twenty dollars and having, according to the appellee's experience, an average expected life of twenty years in service; in 1924 this pole would be ten years in service and one-half of its useful life would have expired. The appellee should have its

original twenty-dollar investment unimpaired, but suppose that the appellant Board found it to have accumulated in its 1924 reserve not ten dollars but fifteen dollars; does the appellee suffer any injustice if the Board should order it to forego further charges to depreciation expense with respect to this pole until five years or less shall have expired; or to carry the example further, suppose at the end of the ten years the Board should find the appellee had charged to expenses and credited to depreciation reserve twenty dollars, the entire cost of the pole; would the appellant Board be depriving the appellee of any property or rights by ordering it to cease making any further charges to depreciation expenses to create any additional reserve with respect to this pole? But under the lower Court's ruling it may continue to charge annually the average sum of one dollar a year notwithstanding that it had already 100% of the cost of the pole in its reserve.

At December 31st, 1924 the company's depreciation reserve amounting to \$19,163,626 (Hill's Affidavit, p. 8) is composed of a multiple of just such excess charges as illustrated above. Can it be reasonably argued that the Board deprived the appellee of its property, in decreasing future charges to depreciation expense until the overcharge of \$4,750,000 shall have ceased to exist? Or, to give another illustration, suppose Jones leases an office from Smith for five years at a rental of \$5,000 per annum. Through an error in the second year Jones pays for the second and third years' rental. Is Smith deprived of property lawfully his if Jones in the next or third year, on being billed for this rent and having discovered the error, says, "You collected my rent for the third year last year, and I am not going to pay you a second time." But says Smith, "I am entitled to a year's rent each year." Should Smith get it a second time and

is Jones estopped from claiming that it is already paid once and it should not be required of him a second time? If the principles laid down by the District Court in this case are sound, he should pay a second time because he is estopped to claim the benefit of the excess payment in the prior year.

In the Court below the appellee made the claim that the United States Supreme Court has decided that the State Board could not interfere with an excessive depreciation reserve fund in the case of *New York Telephone Company v. Prendergast*, 262 U. S., 43. The appellee may make the same claim here. The Court below was satisfied however that the claim was without merit. Certainly the Court below would have seized upon that case as the basis for its decision as a simple and easy way of disposing of this case if it considered that that case had decided the question. A reading of the opinion in the Prendergast case will show that this Court did not refer to depreciation and probably did not consider it as it was not necessary to do so. This Court decided the case on other grounds entirely. It is not to be assumed that this Court decided any question which the opinion shows it did not decide.

POINT IV.

The Court erred in holding that the appellants were estopped from inquiring whether there was an excess in the depreciation reserve; and finding such excess, from requiring that such excess be absorbed.

The Court invoked the doctrine of estoppel and adjudged that since the appellants had existed since 1911 with supervisory power over the appellee's rates and over

the sum included in such rates for depreciation expense and in contribution to the depreciation reserve, and since the appellants had not exercised their power to require appellee to reduce the allowance for this item of expense, they were estopped even though the depreciation reserve built up by means thereof was excessive, from taking such fact into account in their determination as to what allowance on the score of depreciation should be made in the future.

In this we submit the Court erred.

We believe that what we have said under Point III, *supra*, is also an answer to the Court's suggestion of an estoppel but will briefly discuss it further.

In order that there may be a basis of estoppel it must at least appear that the appellee had been misled to its disadvantage by the non-action of the appellants.

There is no foundation for the claim that the appellee was so misled.

If the appellee assumed that any excess in depreciation reserve might be regarded and dealt with by it as profit, its mistake was one of law in nowise attributable to the inaction of appellants.

But beyond this it nowhere appears that the appellee in fact had acted on the assumption that such excess might be distributed or employed by it as profit; nowhere does it appear that in reliance upon appellants' inaction the appellee had regarded itself as relieved from the statutory limitation as to the uses to which such reserve might be put. In fact it was not, under the statute, within the power of appellants to relieve appellee from such limitation.

In carrying the excess upon its books in and as part of the depreciation reserve the appellee recognized that, although in fact it had gone into its property and was not

represented by cash in bank, the so laying of it out was an investment of the fund, which no more lessened the fund than would the investment of a like sum in securities.

The appellee not having been misled to its disadvantage the doctrine of estoppel has no application in the instant case.

In fact, the record shows that the Court below was mistaken in assuming inaction by appellants.

The decision of appellants which was before the Court below states (Rec., p. 51) :

"The company has been on notice for years that it has been charging too much of expenses to create this reserve. As far back as the 1916 rate case the Board (Vol. V, N. J., P. U. R., p. 637) indicated that the company was charging an excessive amount to its expenses to provide for these reserves (\$110,387 minimum—\$394,544 maximum per annum). In 1919 the company claimed that it had charged \$418,000 too much to depreciation expense (VIII, N. J., P. U. R., p. 555)."

If the theory of the Court below that the Public Utility Board of a great and populous State like New Jersey is to be held guilty of laches and estopped from inquiring into and regulating excess accumulations in the depreciation reserve of a utility, it will mean that the public utilities of the country will take unnecessary sums for this purpose with impunity and can never be called to account therefor. It must be remembered that as a practical matter, the question as to whether or not the company is at any time charging too much or too little to depreciation expense can only be ascertained by an examination of the state of the depreciable property of the company in order to determine its percentage condition and existing depreciation. In a company of the

size of the plaintiff in this matter, such an examination requires great detail and is enormously expensive. This appellant Board has all the utilities of the State under its jurisdiction and it is manifestly not possible for it to currently and continuously effect such examination and ascertainment of the physical depreciation accruing in each of the utilities' property under its jurisdiction. Only when the matter arises as it has in this investigation of rates, is it practicable to check the percentage of depreciation found to be actually existing in the property with the percentage of depreciation reserve accumulated by the company to reimburse it for such depreciation or loss in value. With respect to the appellee in this cause, only twice has the opportunity been afforded the Board of checking the amount of reserve against the physical state of the property, the first time in 1916 and the last time in the investigation of rates from which this present action arose.

It is respectfully submitted that the interlocutory order appealed from should be reversed and the injunction granted thereon should be dissolved.

THOMAS BROWN,
Counsel for Appellants.



21
FILED

JAN 18 1926

WM. R. STANSBURY
CLERK

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM—1925

No. **567**

BOARD OF PUBLIC UTILITY COMMISSIONERS and
HARRY V. OSBORNE, JOSEPH V. AUTENREITH
and FREDERICK GNICHTEL, constituting said board
Defendants-Appellants

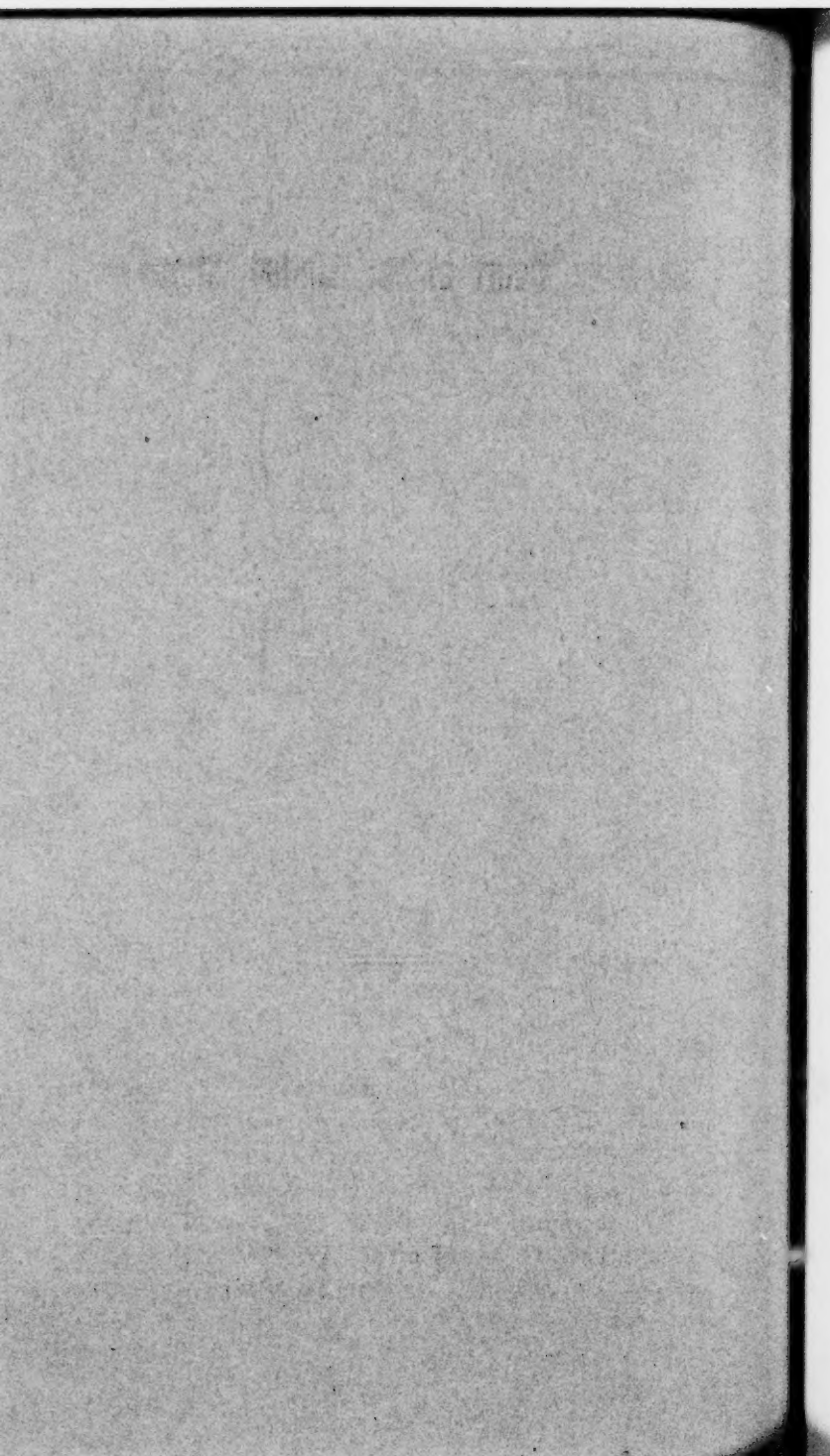
against

NEW YORK TELEPHONE COMPANY
Complainant-Appellee

BRIEF FOR APPELLANTS IN REPLY

THOMAS BROWN
Counsel for Appellants

Appeal Printing Company, 25 Thomas Street, New York City



Supreme Court of the United States

OCTOBER TERM, 1925.

BOARD OF PUBLIC UTILITY COMMISSIONERS
and HARRY V. OSBORNE, JOSEPH F.
AUTENRIETH and FREDERICK GNICHTEL,
constituting said board,

Defendants-Appellants,

against

NEW YORK TELEPHONE COMPANY,
Complainant-Appellee.

BRIEF FOR APPELLANTS IN REPLY.

This reply brief is made necessary by the action of the appellee in incorporating in its brief matters that in our judgment are not presented to this Court on this appeal. Our main brief in accordance with the rules of this Court addressed itself concisely to the sole ground of appeal in the case. That ground of appeal is set forth in our assignments of error and is the ruling that the excess in the amount accumulated by the appellee in its depreciation reserve fund is the absolute and unqualified property of the appellee and cannot be used as a set-off by the Board to the appellee's claim for increased rates.

We had not supposed that appellee's brief would deal with any other questions than the one presented by the appeal and assignments of error. We refer particularly to all matters discussed under Point III in appellee's brief, which point undertakes to prove that the appellant Board

did not value the appellee's property correctly or fix a proper allowance for depreciation of that property. We refer also to Point II of appellees brief which is not directed to the point of the appeal in this case but which is a claim that the appellant Board had no jurisdiction over the appellee the theory of the argument being that the appellee is subject only to the Interstate Commerce Commission.

The matters dealt with in Points III and II of appellee's brief were before the Court below and that Court found against the appellee on all those matters—decided expressly against it on the matters covered by Point III and decided impliedly against it on the matters covered by Point II by ignoring appellee's contention.

There is no question here as to the fairness of the valuation of the appellee's property which was made by the Board nor of the adequacy of the rate of return, viz; 7.53 per cent. which the Board allowed, nor of the fact that there is a surplus exceeding \$4,750,000 in the appellee's depreciation reserve.

The above statement was made in the statement of the case in our brief. It is criticized in the appellee's brief page 8, as being unjustified as each of the matters above mentioned was disputed by appellee. The appellee's brief then states that it proposes to discuss those questions in its brief and does throughout its brief discuss those questions.

We insist that our statement above is correct and that the questions of the value of the appellee's property, the rate of return thereon and the fact of an excess in the depreciation reserve fund of the appellee are not before this Court on this appeal.

The Court below for the purposes of its decision refused to accept appellee's view that the value of its property was higher than that fixed by the appellant Board and that there was not an excess in the depreciation reserve. The Court assumed that the Board was right in those findings, but admitting that the Board was correct in its findings in those respects the Court held that the Board could not consider the excess in the depreciation reserve in fixing rates for the future (R., 238).

We contend that the appellee cannot discuss those questions here. If it desired to attack the decision of the Court below in those respects it should have taken an appeal from the decision. It did not. It cannot now ask this Court to overrule the Court below in regard to questions on which that Court found against it. The appellee cannot use appellants' appeal to reverse any finding of the Court below.

We maintain therefore that all that part of appellee's brief which is devoted to purpose of showing undervaluation of the appellee's property, inadequacy in the amount allowed as current depreciation charges or the non-existence of an excess in the depreciation reserve fund, and in particular Point III of appellee's brief are irrelevant to the case before this Court on this appeal.

The appellant Board was not precluded by the Interstate Commerce Act or the regulations of the Interstate Commerce Commission from fixing charges for depreciation expense for the appellee.

Point II of appellee's brief asserts that the company's charges for depreciation are regulated by the Interstate Commerce Commission and its jurisdiction is exclusive.

While we do not consider that this point is pertinent to the appeal herein for the reasons hereinbefore stated

we make reply to it and will discuss the effect of Congressional action on the jurisdiction of the appellant Board.

a. Congress in extending the power of the Interstate Commerce Commission to telephone companies engaged in interstate commerce, enacted:

“Provided, however, that the provisions of this act shall not apply to * * * the transmission of messages by telephone * * * wholly within one state, and not transmitted to or from a foreign country, from or to any state or territory * * *” (U. S. Comp. St. Supp. 1911, p. 1285).

This proviso constitutes an express declaration by Congress that the jurisdiction conferred upon the Commission shall not extend to the intrastate transmission of messages by telephone.

b. *Each state is therefore free, notwithstanding the extension of the jurisdiction of the Interstate Commerce Commission, to establish intrastate telephone rates, although the state's requirements may disturb the relation between intrastate and interstate rates.*

This proposition is fully supported in the following cases:

In the Minnesota Rate Case (*Simpson v. Shepard*), 230 U. S. 352, the State of Minnesota had established reasonable rates for intrastate transportation throughout the state, and it was contended that, by reason of the passage of the act to regulate commerce, the state could no longer exercise the state-wide authority for this purpose which it had formerly enjoyed; and the Court was asked to hold that an entire scheme of intrastate rates, otherwise validly established, was null and void because of its effect upon interstate rates. There had been no finding by

the Interstate Commerce Commission of any unjust discrimination. The Court under the conditions refused to hold that the State was deprived of jurisdiction.

In *Railroad Commission of Wisconsin, et al. v. Chicago, B. & Q. R. Co.*, 42 Sup. Ct. Rep. 232, it is said:

"Congress as the dominant controller of interstate commerce may, therefore, restrain undue limitation of the earning power of the interstate commerce system in doing state work. * * * it can impose any reasonable condition on a state's use of interstate carriers for intrastate commerce it deems necessary or desirable. This is because of the supremacy of the national power in this field. * * *

"Action of the Interstate Commerce Commission in this regard should be directed to substantial disparity which operates as a real discrimination against, and obstruction to interstate commerce and must leave appropriate discretion to the state authorities to deal with intrastate rates as between themselves on the general level which the Interstate Commerce Commission has found to be fair to interstate commerce.

c. The Interstate Commerce Act, Paragraph (5) of Section 20 provides that:

"The Commission may, in its discretion, prescribe the forms of any and all accounts, records and memoranda to be kept by carriers subject to the provisions of this Act, including the accounts, records and memoranda of the movements of traffic, as well as the receipts and expenditures of moneys * * *, and it shall be unlawful for such carriers to keep any other accounts, records or memoranda than those prescribed or approved by the Commission, * * *

The Commission has prescribed a "Uniform System of Accounts for Telephone Companies."

This section of the Interstate Commerce Act must be read in the light of the fact that in conferring jurisdiction upon the Commission it was expressly provided that the provisions of the act should not apply to the transmission of messages by telephone wholly within one state.

So read the section will not admit of a construction that would result in withdrawing from the states the power to prescribe the forms of accounts as to purely intrastate business, nor to prohibit the keeping by the carriers of accounts as to such business, prescribed by the states.

If it was the intent in the enactment of this section to withdraw from the states the power to prescribe forms of accounts as to purely intrastate business, such intent cannot be given effect. The power of the states over purely intrastate business includes the power to regulate rates and the power of taxation. To the effective exercise of these powers, the power to regulate forms of accounts with respect to such business is essential. To say that the power of the states to regulate the rates for purely intrastate business remains intact, and that the states are without power over the subject of the depreciation charges which may be included in operating expenses, and that the extent of the inclusion of such charges in such expenses rests in the uncontrolled will of the carriers is a manifest absurdity, for the carriers through such uncontrolled power could at will render nugatory the states' power of regulation.

The Act was amended in 1920, authorizing the Commission to prescribe the classes of property for which depreciation charges may properly be included under operating expenses, and the percentages of depreciation which shall be charged with respect to each of such classes of property.

The Commission has not as yet exercised the power

conferred. The matter is now the subject of investigation by it.

It is true, that the Uniform System of Accounts for Telephone Companies, prescribed by the Commission in 1912, eight years before the amendment to the Act now considered, does deal with the subject of depreciation expense. Such system of accounts, however, does not as the amendment requires, "prescribe the classes of property for which depreciation charges may properly be included under operating expenses" nor "the percentages of depreciation which shall be charged with respect to each of such classes of property." Such system of accounts merely requires the accounting company *to base its depreciation charges upon rules to be determined by itself*, which rules must be derived from "a consideration of the company's history and experience."

This subject was considered and a conclusion in accord with the contentions here advanced was reached in:

Indiana Bell Telephone Co. v. Public Service Commission, 300 Fed. Rep., 205, where the Court said:

"Plaintiff urges that the commission was without jurisdiction to fix a rate of depreciation because it claims that that was a matter wholly within the jurisdiction of the Interstate Commerce Commission. I do not deem it necessary to go into the question of the relative rights of a state Public Utility Commission and of the Interstate Commerce Commission in regard to rate of depreciation, because I am satisfied that section 435 of the Transportation Act (Comp. St. Ann. Supp. 1923, par. 8592), shown in Exhibit 21, contemplates that the commission shall only arrive at a proper rate of depreciation by some of the usual and well known methods of investigation, and that until it has done so it cannot prescribe a rate of depreciation for other than bookkeeping and reporting purposes.

“The letter, notice, or order, whichever it may be termed, introduced in evidence, indicates that the Interstate Commerce Commission had not up to that time made any investigation or arrived at any rate which it deemed proper for rate-making purposes, and that it had not, therefore, at the time the Indiana commission acted in this case, assumed any jurisdiction or control over telephone rate making that would deprive the Indiana commission of its undoubted right to fix a rate of depreciation, if not thus affected.”

Respectfully submitted,

THOMAS BROWN,
Counsel for Appellant.

Supreme Court of the United States,

OCTOBER TERM, 1925.

No. 567.

BOARD OF PUBLIC UTILITY COMMISSIONERS AND HARRY
V. OSBORNE, JOSEPH V. AUTENREITH AND FREDERICK
GNICHTEL, CONSTITUTING SAID BOARD,

Appellants,

against

NEW YORK TELEPHONE COMPANY,

Appellee.

BRIEF FOR APPELLEE.

CHARLES M. BRACELEN,
THOMAS G. HAIGHT,
CHARLES T. RUSSELL,
FRANKLAND BRIGGS,

Counsel for Appellee.

Comm' counsel that in 1924 he would be shut / 300



SUBJECT INDEX.

	PAGE
STATEMENT OF THE CASE.....	1
The Bill and Supporting Affidavits.....	4
The Answers and Opposing Affidavits.....	6
The Opinion of the Court Below.....	7
Errors in the Appellants' Statement of the Case.	8
SUMMARY OF ARGUMENT.....	9
ARGUMENT	12
POINT I—The requirement of the Board that the	
Company overcome an admitted deficit in its	
annual earnings by revising retroactively the	
depreciation expense actually charged in the	
past is illegal and compliance with such re-	
quirement would confiscate the property of	
the Company.....	
	12
Character of depreciation expense charges	
and account for accrued depreciation..	
	12
The property bought with the moneys	
credited to depreciation account is in all	
respects the property of the Company	
and does not represent a contribution by	
the telephone rate payers.....	
	14
The Board's finding of an alleged excess in	
the depreciation account is untrue in	
fact	
	15
The improper use by the Board of an	
alleged excess in the depreciation account	
to overcome the shortage in annual earn-	
ings under a fair return is shown by its	
opinion and the computations therein..	
	16

The parts of the Board's order and decision discussed had reference to the operations of 1924 under the enjoined rates—the results of operations for 1925 as estimated by it are shown in its opposing affidavits and make even clearer the illegality of the Board's action.....	19
The per cent. return on the intrastate property and business alone is less than on the entire property and business.....	21
The Company cannot be punished in the manner attempted by the Board for its lawful operations in the past.....	22
A similar proposed treatment by a State Commission of an alleged excess in the depreciation account of the Company was before this Court in <i>Prendergast v. New York Telephone Co.</i> , 262 U. S. 43..	26
The Board's treatment of the alleged balance in the depreciation account would, if enforced, require the Company indirectly to make charges against it not permitted by the Uniform System of Accounts prescribed by the Interstate Commerce Commission	29
POINT II—The Company's charges for depreciation expense are regulated by the Interstate Commerce Commission and its jurisdiction is exclusive; the order of the Board is, therefore, invalid and its enforcement was properly enjoined.....	30
Exclusive jurisdiction of Interstate Commerce Commission	31
The act applies to the property as a whole and to all its parts and only one depreciation charge can be applied.....	40

III

	PAGE
POINT III—Without regard to the questions argued in the foregoing points the preliminary injunction properly was granted upon all the evidence before the Court below.	42
The order of the Board if enforced would confiscate the property of the Company by reducing its value more than \$14,000,000. The Board erred both in law and in fact in its finding as to the value of the property	42
The Board did not meet the proof of the Company as to the cost and value of its <i>intrastate</i> property or as to the results of the operation of its <i>intrastate</i> business under the telephone rates enjoined.	45
The telephone rates enjoined did not produce and could not produce a fair return upon the value of the Company's property, nor even upon its cost. This is so whether the entire property and business be considered or the intrastate property and business alone.....	47
The order of the Board requires the Company to charge for depreciation expense an amount less than the actual expense of depreciation and hence if enforced would work continuing confiscation of the Company's property.....	48
POINT IV—There was no abuse of discretion by the Court below.....	52
CONCLUSION	53

IV

TABLE OF STATUTES AND CASES CITED.

STATUTES.

	PAGE
Interstate Commerce Act	6, 10, 31, 35, 38
Judicial Code, Sec. 266	1
Public Utilities Act of New Jersey (Ch. 195 L. 1911, as amended, Section 17(h))	3
41 U. S. Stat. L. 456; 474	32
41 U. S. Stat. L. 456; 493	35

CASES.

<i>Adams Express Co. v. Croninger</i> , 226 U. S. 491	39
<i>Banton v. Belt Line R'y Corp.</i> , 268 U. S. 413	50
<i>Charleston & C. R. Co. v. Varnville Furniture Co.</i> , 237 U. S. 597	40
<i>Chicago, R. I. & P. Railway Co. v. Hardwick Elevator Co.</i> , 226 U. S. 426	39
<i>Chicago Great Western Ry. Co. v. Kendall</i> , 266 U. S. 94	11, 52
<i>City of Amarillo v. Southwestern Tel. & Tel. Co.</i> , 253 Fed. 638	52
<i>Copper Queen Consolidated Mining Co. v. Arizona</i> , 206 U. S. 474	39
<i>Erie R. Co. v. People</i> , 233 U. S. 671	39
<i>Garden City v. Garden City Telephone, Light & Mfg. Co.</i> , 236 Fed. 693	10, 23
<i>Galveston Electric Co. v. Galveston</i> , 258 U. S. 388 ..	10, 22, 24
<i>Interstate Commerce Commission v. Goodrich Transit Company</i> , 224 U. S. 194	38
<i>Knoxville v. Knoxville Water Co.</i> , 212 U. S. 1	10, 22, 26
<i>Louisiana Railroad Commission v. Cumberland Tel. Co.</i> , 212 U. S. 414	25

	PAGE
<i>McDermott v. Wisconsin</i> , 228 U. S. 115.....	39
<i>Meccano, Ltd. v. Wanamaker</i> , 253 U. S. 136.....	52
<i>Michigan Central R. Co. v. Vreeland</i> , 227 U. S. 59.....	39
<i>The Minnesota Rate Cases</i> , 230 U. S. 352.....	4, 11, 48
<i>Missouri Rate Cases</i> , 230 U. S. 474.....	11, 48
<i>Monroe Gaslight & Fuel Co. v. Mich. P. U. Com.</i> , 292 Fed. 139.....	10, 23, 52
<i>National Lead Co. v. United States</i> , 252 U. S. 140....	39
<i>New York, New Haven and Hartford Railroad Co. v.</i> <i>Interstate Commerce Commission</i> , 200 U. S. 361..	39
<i>New York Central R. Co. v. Winfield</i> , 244 U. S. 147..	40
<i>Newton v. Consolidated Gas Co.</i> , 258 U. S. 165....	10, 22, 23
<i>N. Y. Telephone Co. v. Prendergast</i> , 300 Fed. 822....	5, 46, 50
<i>New York Tel. Co. v. Prendergast</i> , U. S. Dist. Ct. S. D. N. Y., In Equity, No. 23-252, not reported officially	28
<i>Northern Pacific R. Co. v. Washington</i> , 222 U. S. 370.	39
<i>Northwestern Bell Tel. Co. v. Spillman</i> , 6 Fed. (2d) 663	50
<i>Ohio Utilities Co. v. P. U. C. of Ohio</i> , 267 U. S. 359...	44
<i>Pennsylvania R. Co. v. Public Service Commission</i> , 250 U. S. 566.....	40
<i>Postal Telegraph-Cable Co. v. Warren-Godwin Co.</i> , 251 U. S. 27.....	40
<i>Prendergast v. New York Telephone Co.</i> , 262 U. S. 43.	5, 11, 26, 28, 46, 52
<i>Smyth v. Ames</i> , 169 U. S. 466.....	42
<i>Southern R. Co. v. Reid</i> , 222 U. S. 424.....	39
<i>Southern R. Co. v. Indiana</i> , 236 U. S. 439.....	39
<i>Southwestern Bell Telephone Co. v. City of Fort</i> <i>Smith</i> , 294 Fed. 102.....	50
<i>Southwestern Bell Telephone Co. v. Public Service</i> <i>Commission</i> , 262 U. S. 276.....	50
<i>St. Louis, I. M. & S. Ry. Co. v. Edwards</i> , 227 U. S. 265	39

VI

<i>Taylor v. Taylor</i> , 232 U. S. 363.....	PAGE 39
<i>Texas & Pacific R. Co. v. Rigsby</i> , 241 U. S. 33.....	40
<i>United States v. Cerecedo Hermanos y Compania</i> , 209 U. S. 337.....	39
<i>United States v. G. Falk & Bro.</i> , 204 U. S. 143.....	39
<i>United States v. Philbrick</i> , 120 U. S. 52.....	39
<i>Van Wert Gaslight Co. v. Public Utilities Commis- sion of Ohio</i> , 299 Fed. 670.....	52
<i>Westinghouse El. & Mfg Co. v. Denver Tramway Co.</i> , 3 Fed. (2d) 285.....	44

Supreme Court of the United States.

OCTOBER TERM, 1925

No. 567

BOARD OF PUBLIC UTILITY COMMISSIONERS and HARRY V. OSBORNE,
JOSEPH V. AUTENREITH and FREDERICK GNICHTEL, constituting said Board,

Appellants,

against

NEW YORK TELEPHONE COMPANY,
Appellee.

BRIEF FOR APPELLEE.

Statement of the Case.

This is an appeal from an interlocutory injunction order (R. 240), made by a Court of three judges (Buffington, *C.J.*, Rellstab and Morris, *D.J.J.*) constituted in accordance with the provisions of Section 266 of the Judicial Code and filed on May 12, 1925. The Company has furnished the bond of \$2,000,000 thereby required (R. 243). The opinion of the Court below (R. 237) is reported, 5 Fed. (2nd) 245.

The facts leading up to and involved in this litigation are, briefly stated, as follows:

The appellee is a corporation of the States of New York and New Jersey, owning and operating a telephone system and furnishing telephone service in the northeasterly section

of the State of New Jersey, throughout the State of New York, and in a portion of the State of Connecticut (Bill, R. 3). The appellants constitute an administrative Board for the State of New Jersey, possessing regulatory powers in that State over public service corporations (Bill, R. 4).

The territory of the Company in the State of New Jersey is divided into so-called "local areas". The exchange service is service between telephones, or, in telephone parlance, "stations", in the same local area. When the service is between stations in different local areas it is known as toll service (R. 3). Toll service is both intrastate and interstate and the plant and facilities of the company used in furnishing service are used in each kind of service, exchange, toll, intrastate and interstate (R. 8, 74).

For the last ten years prior to the commencement of this suit the rates of the Company in New Jersey, both exchange and toll, have been substantially at the same level. Slight changes were made but there was no general increase involving any substantial addition to the revenue of the company (Bill, R. 5; R. 143-144), although it is a well-known fact that the price of practically everything else has risen during the war-period or in the years immediately succeeding the war. The company, however, was not unaffected by the change in price levels or in the increase in living costs. Higher material prices have caused increases in the cost of all the equipment entering into a telephone system with the result that construction costs for a given amount of equipment are substantially higher than they were in the pre-war period (R. 103-112).

The expense of operating a telephone system consists in large part of wages paid to employees. As living costs rose the company was obliged to increase wages with the result that there has been a large increase in its expenses. During this period of increasing costs, both of construction and of operating expenses, the rate level, as has been stated above, has remained the same; in other words, the company has carried on its business under changed conditions with no

increase in rates. *It has received the same number of dollars for its service but in purchasing power these dollars are now 60 cent as compared with 100 cent dollars in 1914* (R. 145).

Prices for materials and labor costs for the last two or three years have remained at a level which seems likely to be continued for some years to come and there is no probability that falling prices in the near future will restore the condition that existed prior to the war (R. 117). It was this situation which led to the increase in rates proposed by the Company in 1924 and which resulted in the order made by the appellant Board and complained of in this suit.

Under the provisions of the Public Utilities Act of New Jersey (Ch. 195, L. 1911, as amended) the initiative in rate-making remains with the company. There are, however, in Section 17(h) of the Act certain provisions applicable when public utilities make increases in rates. The Board is given a limited suspension power and the burden of proof of the reasonableness of the increase is placed upon the utility. The section in question is printed in the footnote.

On March 6, 1924, the company filed with the Board schedules of rates applicable to service in New Jersey to be effective April 1, 1924 (R. 5). The new schedules provided very generally for increases in the rates for exchange service; no increase in the toll rates was proposed.

The Board on March 11, 1924, made an order providing for an investigation of these new rates and ordered their sus-

"(h) When any public utility as herein defined shall increase any existing individual rates, joint rates, tolls, charges or schedules thereof, as well as commutation, mileage and other special rates or change or alter any existing classification, the board shall have power either upon written complaint or upon its own initiative to hear and determine whether the said increase, change or alteration is just and reasonable. The burden of proof to show that the said increase, change or alteration is just and reasonable shall be upon the public utility making the same. The board shall have power pending such hearing and determination to order the suspension of the said increase, change or alteration until the said board shall have approved said increase, change or alteration, not exceeding three months. If such hearing shall not have been concluded within such three months, the board shall have power during such hearing and determination to order a further suspension of said increase, change or alteration for a further period not exceeding three months. It shall be the duty of the said board to approve any such increase, change or alteration upon being satisfied that the same is just and reasonable."

pension until October 1, 1924, but when October 1st was approaching and the investigation was still incomplete, the suspension period was further extended until January 1, 1925, by the consent of the company (R. 6).

On December 31, 1924, the Board made the order complained of in this suit, incorporating therein a decision of considerable length (Exhibit A to the Bill, R. 16 to 70). The order disallowed the increase in rates as filed by the company and stated that at that time no increase in rates would be approved. The order furthermore made specific directions as to the handling of the Company's depreciation expense, prescribed rates therefor and made adjustments therein intended to make up a deficiency in net revenues below a fair return through the "absorption" of an *alleged* excess in the Company's reserve account for depreciation.

This order of the Board effectively barred the Company from any possible relief in the way of increased service rates; it not only disallowed specifically the increases in rates proposed by the Company but disallowed *any increase* in rates whatever.

As the order prevented the Company from earning a fair return upon the fair value of its property devoted to the rendition of its service, it brought this suit on January 29, 1925, to enjoin the enforcement of such order on the ground that it would, if enforced, confiscate the property of the Company in violation of its rights under the Fourteenth Amendment to the Constitution of the United States, and on the further ground that it interfered unlawfully with interstate commerce.

The Bill and Supporting Affidavits.

The service furnished by the Company in the State of New Jersey is both intrastate and interstate and, therefore, in accordance with the established rule in suits of this character (*The Minnesota Rate Cases*, 230 U. S. 352, 435), the Company shows separately in its Bill and affidavits the value of its property employed in its intrastate business in New Jersey

and its earnings and expenses in connection with that business (Bill, R. 6-7; Affidavits, R. 85-89).

The Company's accounts are kept in accordance with the Accounting System and Regulations prescribed by the Interstate Commerce Commission which have also been adopted and approved by the appellant Board. As so kept the accounts do not separate the Company's property used in its service in New Jersey between intrastate and interstate business, nor do they separate the revenues and expenses relating to said classes of business (R. 84). An apportionment has, therefore, been made and is shown in the Bill and supporting affidavits. This apportionment (R. 94-103) is made by the same methods and on the same basis and by the same affiant as in the two suits of the Company which involved its intrastate property and business in the State of New York brought in the Southern District of New York in 1922 and 1924 (*Prendergast v. N. Y. Telephone Co.*, 262 U. S. 43; *N. Y. Telephone Co. v. Prendergast*, 300 Fed. 822).

The Bill in this suit also follows closely the form of the Bill in the New York suits of the Company above referred to. In the first of those suits the sufficiency of the Bill was attacked but was approved by this Court (262 U. S. at page 47).

However, the Company, in order that the Court might have before it a complete picture of all of its business in the State of New Jersey, did not stop at showing the figures relating to its intrastate property and business alone, but also set forth the figures relating to its entire business and property in that State, both intrastate and interstate (R. 7, 8, 90-94). These figures show that the Company's rate of net return on its purely intrastate business is much less than on its entire operations in New Jersey (R. 6, 7, 85-94). In other words, the interstate business is far more profitable than the intrastate business under the rates imposed upon the Company by the Board.

No separation of the purely intrastate business was presented in the proceedings had before the Board which resulted

in the order complained of, as it is neither customary nor necessary to do so in such a hearing which is held for the purpose of determining *just and reasonable* rates (R. 89).

The Bill alleges (R. 13-14), and the allegations are supported by the Company's affidavits (R. 88), that if the order of the Board was enforced, the Company would be prevented from earning any return in excess of the following percentages per annum upon the value or cost of its property used in its *intrastate* business and upon the value or cost of its entire property used in *both its intrastate and interstate* business:

	Return upon Value	Return upon Cost
Intrastate Property.....	0.40%	0.46%
Entire property, both intrastate and interstate.....	3.56%	4.12%

The Company alleges that it is entitled to an annual return of 8% upon the fair value of its property (R. 7). The Board concedes that the Company should have an annual return of at least $7\frac{1}{2}\%$ upon fair value (R. 13).

The Bill further alleges (R. 8-13), and the allegations are supported by the moving affidavits, that the provisions of the order of the Board which fix the charges of the appellee for depreciation expense would, if enforced, confiscate the property of the Company (R. 124) and that such provisions are in conflict with the Interstate Commerce Act and the orders and regulations of the Interstate Commerce Commission and, therefore, invalid and beyond the powers of the Board (R. 135-139).

The Answers and Opposing Affidavits.

The Board, in its decision (R. 38, 39) found that for 1924 the service rates then in existence (and complained of in this suit) would fail to produce a fair return upon the value of the Company's entire property (interstate and intrastate) by \$1,300,000. It found further, upon the

opinion of its engineer, that there was an excess of \$4,750,000 in the Company's depreciation reserve due, as it claimed, to the inclusion in the expenses of past years of an excessive amount for depreciation expense. It sought to justify a continuance of the old service rates by requiring the Company to charge to depreciation expense after January 1, 1925, a sum less than the amount which the Board itself found was the proper annual depreciation expense to the extent necessary to wipe out the *admitted shortage* under a fair annual return. It also decided that the depreciation expense rates which the Company was charging were excessive and should be reduced materially in the future. In arriving at the rate base the Board fixed the value of the Company's entire property in New Jersey at \$14,000,000 less than the sum which the Company's proof showed was a fair and reasonable value.

Its answering papers in the main seek to justify and support the Board's decision as to the treatment of the alleged excess in the depreciation reserve account. The question of the separate value of the Company's property devoted to the intrastate business and its revenues and expenses in connection with that business were not before the Board in its investigation. The answering affidavits, while they in some respects criticise the method adopted by the Company in separating its interstate and intrastate property and business, *fail to set up any figures for that property and business.*

Furthermore, the answering affidavits set forth an estimate of the return for the year 1925 under the enjoined service rates. This shows that, using the Board's own rates of depreciation expense, these enjoined service rates would produce on the *average cost* and on the *average fair value* of the entire property as fixed by the Board annual returns of only 5.4% and 4.93% respectively (R. 211).

The Opinion of the Court Below.

The motion was very fully argued in the Court below, two days being devoted to it (R. 1). The Court granted the motion (R. 238) primarily on the ground that the action of the Board in seeking to make up the admitted

504

deficit in annual earnings by attempting to absorb an *alleged* excess in the depreciation reserve account was unjustified. The Court also indicated that if the value of the Company's property devoted to intrastate service and its revenues and expenses connected therewith, should be alone considered, the return which the enjoined rates would produce manifestly would be confiscatory (R. 239). The order which was entered nearly two months after the motion was argued enjoined the enforcement of the order of the Board and required the Company to file a bond in the penal sum of \$2,000,000 for the protection of its subscribers (R. 240).

Errors in the Appellants' Statement of the Case.

On page 4 of its brief the Board states: "There is no question here as to the fairness of the valuation of the appellee's property which was made by the Board nor of the adequacy of the rate of return, viz; 7.53 per cent. which the Board allowed, nor of the fact that there is a surplus exceeding \$4,750,000 in the appellee's depreciation reserve." Such a statement is unjustified. On the contrary each of the questions or matters referred to in the above quotation from the Board's brief was disputed and put in issue by the Bill and moving papers (R. 6, 7, 13, 81-83, 113, 115, 127) and the evidence before the Court below in reference to them will be discussed under the points in this brief to which they relate.

The Company submits that the Court below was right upon the main ground referred to in its opinion and also that upon all the evidence before that Court it exercised properly its discretion in granting a preliminary injunction.

SUMMARY OF ARGUMENT.

POINT I.

The requirement of the Board that the Company overcome an admitted deficit in its annual earnings by revising retroactively the depreciation expense actually charged in the past is illegal and compliance with such requirement would confiscate the property of the Company.

Upon the face of the opinion of the Board (R. 38, 39) and its affidavits (R. 211) it appears that, using the Board's own property valuation and its computation of revenues and expenses, under the telephone rates required by the Board to be continued in force the Company would suffer a deficit of \$1,300,000 in 1924 (R. 39) and \$2,631,281 in 1925 (R. 211) below the annual return found by the Board to be fair.

In order to get rid of this shortage below a fair annual return the Board allows the Company as an annual depreciation expense a sum substantially less than the Board itself finds to be the actual, normal, currently accruing depreciation (see opinion of Court below, R. 238), until an alleged excess of \$4,750,000 in its "depreciation reserve" shall have been "absorbed". The Company denies the existence of any such excess, or of any excess whatever, and such denial is supported by its affidavits (R. 127). Moreover, the present balance in this account was built up prior to the Board's order under service rates lawful at the time when charged and during a period when no depreciation expense rates had been prescribed by the appellants or their predecessors in office.

There is no justification in law or equity for any such treatment of the Company's past expenses.

Newton v. Consolidated Gas Co., 258 U. S. 165, 175;

Galveston Electric Co. v. Galveston, 258 U. S. 388;

Knoxville v. Knoxville Water Co., 212 U. S. 1;

Monroe Gaslight & Fuel Co. v. Mich. P. U. C., 292 Fed. 139, 147;

Garden City v. Garden City Telephone, Light & Mfg. Co., 236 Fed. 693.

POINT II.

The Company's charges for depreciation expense are regulated by the Interstate Commerce Commission and its jurisdiction is exclusive; the order of the Board is, therefore, invalid and its enforcement was properly enjoined.

The Company is a common carrier engaged in interstate commerce as defined and provided in the Interstate Commerce Act and is subject to the jurisdiction of the Interstate Commerce Commission. Its depreciation expense must be and has been determined in accordance with the orders of the Interstate Commerce Commission. Under the orders of that Commission the Company contends that it is compelled to charge its present rates of depreciation and that the jurisdiction of the Interstate Commerce Commission in that regard is exclusive.

POINT III.

Without regard to the questions argued in the foregoing points the preliminary injunction properly was granted upon all the evidence before the Court below.

1. The order of the Board if enforced would confiscate the property of the Company by reducing its value more than \$14,000,000. The Board erred both in law and in fact in its findings as to the value of the property.

2. The Board did not meet the proof of the Company as to the cost and value of its *intrastate* property or as to the results of the operation of its *intrastate* business under the telephone rates enjoined.

3. The telephone rates enjoined did not produce and could not produce a fair return upon the value of the Company's property, nor even upon its cost. This is so whether the entire property and business be considered or the intrastate property and business alone. Under such circumstances the Company was entitled to interlocutory relief.

The Minnesota Rate Cases, 230 U. S. 352, at pp. 470-472;

Missouri Rate Cases, 230 U. S. 474, at pp. 507-508.

4. The order of the Board requires the Company to charge for depreciation expense an amount less than the actual expense of depreciation and hence if enforced would work continuing confiscation of the Company's property.

POINT IV.

There was no abuse of discretion by the Court below.

Prendergast v. New York Telephone Co., 262 U. S. 43, 51-52;

Chicago Great Western Ry. Co. v. Kendall, 266 U. S. 94, 100.

A R G U M E N T.

P O I N T I.

The requirement of the Board that the Company overcome an admitted deficit in its annual earnings by revising retroactively the depreciation expense actually charged in the past is illegal and compliance with such requirement would confiscate the property of the Company.

The character of the depreciation expense charges and the account for accrued depreciation.

At the outset of the argument of this point it would seem proper to explain this subject briefly as many of the statements in the Appellants' brief in reference to it are incorrect.

There is no "reserve" in the sense of a fund. The depreciation account, designated "Reserve for Accrued Depreciation" in the I. C. C. system of accounts for telephone companies, is a piece of accounting machinery by which the cost of plant used up in furnishing the service, less the net salvage recovered when it is retired from service, is charged to expense evenly over the life of the property in service. *The money represented by the balance in this account is invested in property to take the place of property retired.* The accounting is as follows:

When a unit of property goes into service it is irrevocably committed to the enterprise and becomes at once subjected to all causes that destroy such property and lead to its retirement. These causes are the ordinary action of the elements that result in rust, rot and decay; wear and tear; progress in the art that may lead to obsolescence or inadequacy; other inadequacy, such, for example, as results from the growth

and development of the community; public requirements, such, for example, as municipal ordinances requiring the abandonment of pole lines and the substitution of underground construction; storms, in particular sleet storms that are very destructive to overhead lines; and other casualties.

This using up of the property in furnishing telephone service is an expense of operation.

In the Company's accounting system (prescribed by the Interstate Commerce Commission, to whose jurisdiction the Company is subject, and approved by the appellant Board) this expense is based on the actual original cost of the property, less net salvage, so that the total of this expense on account of any unit of property is its original cost less the net salvage.

This expense is charged in the accounts at a rate per cent. of the actual cost, determined separately for each class of depreciable property in accordance with the estimated average service life and salvage of the units of each class. It is charged month by month, so as to spread it as evenly as may be over the life of the unit of property in service. Therefore, the charge to depreciation expense on account of any unit begins when it is put into service and continues until it goes out, based upon its expected life and salvage. These estimates are corrected, and the expense ratio modified, from time to time as experience and judgment indicate.

When the *charge* to expense is entered on the books a *credit* entry in the same amount is concurrently made in the account Reserve for Accrued Depreciation. When a unit of property goes out of service (no matter what the cause), *no charge to expense is made*, but its original cost less the net salvage is written out of the account Reserve for Accrued Depreciation. This is the *debit* entry. The charges to expense have already been made, month by month.

The balance appearing on the books of the Company in the account Reserve for Accrued Depreciation and referred to in the opinion of the Board (R. 49-50) is the balance from the credit and debit entries in that account. All future retirements of units of plant will be charged to that account.

In short, the accounting machinery is this:

When property goes into the plant the cost of it goes into the capital accounts. While the property remains in the plant a per cent. of its cost, based on the service life, is charged monthly as an expense of operation, and the same amount goes into the account "Reserve for Accrued Depreciation." When the property is taken out of the plant, (1) no further expense is then charged, (2) the cost is taken out of the capital accounts, and (3) the cost is taken out of the account "Reserve for Accrued Depreciation."

The accounting rules on depreciation expense as prescribed by the accounting system are more fully described in the Company's affidavits (R. 131-143; Addition to Record, p. 9).

What the Company has done is this: Against the time when the property will be gone, the Company has taken a part of its operating earnings and bought other telephone property, of the same kind or other kinds. The Company has in this way protected its investment and its financial structure.

The property bought with the moneys credited to the depreciation account is in all respects the property of the Company and does not represent a contribution by the telephone rate payers.

In the opposing affidavits of the Board and also in its brief (p. 11) the idea is set forth that the credits to the depreciation account have been "contributed" to the Company by the rate payers. This idea has its root in the notion that the subscribers, instead of paying the Company for telephone service, pay an amount for wages and salaries, another amount for taxes, for depreciation expense, for interest, for dividends, etc. Such an idea is incorrect and unwarranted (Addition to Record, p. 10).

There are no tagged dollars. The so-called reserve is a mere matter of book-keeping. No separate allowance or rate

has been paid to the Company by its subscribers for depreciation or any other item of expense. All the operating revenues go into the treasury of the Company. The fact is that the Company sold its service for a price regulated by the State, subject to constitutional limitations. The service belonged to the subscribers because they paid for it and the money was the Company's because the Company earned it. The money has been invested in telephone property, and this property bought by the Company with the money it earned is the Company's property.

The Board's finding of an alleged excess in the depreciation account is untrue in fact.

A In its opinion (R. 49-50) the Board found that there was an excess in this account at the end of the year 1924 of over \$4,750,000. This finding rests solely upon the *opinion* of its engineering expert Mr. Hill, a young man who has had no practical experience in financial or operating management of telephone properties (R. 187). The excess found by the Board is an excess above what its said engineer terms "present requirements." He makes his estimate of present requirements by carrying back his estimated present depreciation rates into the past years and consequently his finding of an excess is bound up with the accuracy of his estimate of present annual depreciation rates and rests upon the same factors; namely, the average life and salvage as *estimated* by him.

Even were his estimated depreciation expense rates correct for the future it does not follow that they were right for the past.

The Company strongly denies the existence of any such excess as found by the Board, or of any excess whatever, in its depreciation account and the unsoundness of the Board's findings is shown in detail in the Company's affidavits (R. 117-129).

As to the fact of an excess, if it were material, a direct issue would be presented that could only be determined after a trial.

The improper use by the Board of an alleged excess in the depreciation account to overcome the shortage in annual earnings under a fair return is shown by its opinion and the computations therein.

The order and opinion of the Board are set forth in full as Exhibit A to the Bill (R. 16X-70). The average value of the entire property in New Jersey (intrastate and interstate) for the year 1924 is found by the Board to be \$76,370,000 (R. 32). On this value the Board finds that the Company is entitled to an annual return of from \$5,750,000 to \$6,000,000 (R. 36). This is at a rate of approximately 7½%. The Board then states its findings as to the Company's entire operations in New Jersey under the enjoined rates for the year 1924 as follows (R. 38) :

"Results under Present Rates—Estimated for the Year 1924

	By Company (Exhibit P-14)	By Board, based on Exhibit C-34 modified
Revenues:		
Exchange Revenues.....	\$11,936,000	\$11,936,000
Toll Revenues.....	10,465,000	10,465,000
Miscellaneous Operating.....	257,000	257,000
Total Telephone Revenue.....	\$22,658,000	\$22,658,000
Expenses:		
Traffic Expenses.....	\$5,846,000	\$5,846,000
Commercial Expenses.....	2,309,000	2,309,000
General and Miscellaneous Expenses.....	548,000	548,000
Uncollectible Operating Revenues....	150,000	150,000
Rent and Other Deductions..... (1)	283,000	283,000
Current Maintenance..... (1)	3,230,000	3,230,000
Depreciation	3,452,000	2,678,000
Taxes	2,170,000	2,200,000
Licensee Revenue, Dr.....	965,000	965,000
Total Telephone Expenses.....	\$18,953,000	\$18,209,000
Total Telephone Earnings.....	\$3,705,000	\$4,449,000

(1) Include a certain portion of depreciation for right of way from clear accounts.

(2) Omits concessions (\$102,000) and interest during construction (\$160,272 aggregating \$262,727 in Exhibit C-34" (*italics ours*)).

As stated at the heading of the above table the figures used were estimates, as they were considered by the Board before the complete results of the operations in 1924 were known. The actual results for that year are stated in the Company's affidavits (R. 92) and show that the net earnings of the Company were about \$300,000 less than the estimate in the above table.

If the Court will examine this table of figures it will see that the Board sets up two parallel columns, *both under the telephone rates enjoined*, one showing the figures of the Company, and the other those figures as modified by the Board. From a comparison of the two columns it will be noted that the revenues stated by the Board are exactly the same as the Company's figures. The expenses used by the Board are also identical with those of the Company except in two particulars; namely, the depreciation and the taxes. The change in taxes results from the adjustment of expense in connection with depreciation which, by making an addition to the net revenue, increases the income taxes accordingly. The real difference between the two columns results from the handling of one expense item, namely, depreciation, which, in the modified figures adopted by the Board is reduced by the amount of \$774,000 for the year 1924. The arbitrary reduction of this actual expense item is one of the errors complained of by the Company and will be discussed in a later point of this brief.

The Board then points out (R. 39) that even after making the arbitrary reduction in the depreciation expense item just mentioned the net revenues are short of the fair return allowed by the Board itself by an amount approximately \$1,300,000. This conceded shortage plus the depreciation expense item of \$774,000 above referred to makes the total shortage in the operations of the year 1924 on the Board's computation, \$2,074,000. [It is of interest to note here that the proposed rates which the Board refused to approve would have increased the Company's revenues by only \$2,300,000 annually (R. 144)].

In order to get rid of this *admitted deficit* in the Company's earnings the Board resorts to an unlawful and retro-active revision of the Company's depreciation expense which has been actually charged in the past. Specifically, the method employed to accomplish this is by directing that future charges to depreciation expense be reduced below the amount which the Board itself thinks proper to the extent necessary to make up the admitted deficit in annual earnings and that this be continued until such time as the sum of \$4,750,000, *alleged* by the Board to be an accumulated excess in the depreciation reserve, shall have been absorbed (Bill, R. 13; R. 39).

The Board in its decision then says (R. 39) :

"In the opinion of the Board, the company should, beginning January 1st, 1925, compute the total normal charges to depreciation expense by use of the annual depreciation rates as hereinafter provided. From the amount so computed it should ~~deduct~~ an amount sufficient to allow the net telephone earnings for a given period (month or year) to equal a fair return on the value of its property in service as herein found by the Board. / These deductions should be made until their total is equal to \$4,750,000 herein found as the minimum amount which has heretofore been charged to depreciation expenses over and above the amount which will be found as a credit in the depreciation reserve to be set up on January 1st, 1925 as herein provided.

"The result of this procedure will be that it will not be necessary for the company to collect as much from the rate payer for depreciation expense *as it would have to charge if this excess balance in the depreciation reserve did not exist* and will make it possible for the company to earn a fair return on the value herein fixed without resorting to an increase in its rates at this time." (Italics ours.)

Previously in its decision the Board had said (R. 20) :

“While it appears that no increase in rates is found to be justified at this time for reasons hereinafter indicated” (i. e., the alleged excessive balance in the depreciation reserve) “it is apparent that *when the excess in the depreciation reserve has been absorbed the rates may have to be readjusted.*” (Italics ours.)

The parts of the Board's order and decision discussed above had reference to the operations of 1924 under the enjoined rates—the results of operations for 1925 as estimated by it are shown in its opposing affidavits and make even clearer the illegality of the Board's action.

In its opposing affidavits the Board gives its estimate of the Company's operations during the year 1925 under the enjoined telephone rates, *computing depreciation expense at its own rates* and using its own valuation of the property as the base to which to apply the rate per cent. of annual return. This estimate of the Board is as follows (R. 211) :

**"ESTIMATED RATE OF RETURN
DURING YEAR 1925
UNDER PRESENT RATE SCHEDULE.**

	Plaintiff's Depreciation Rate	Board's Depreciation Rate	Compliance with Order of Board
Telephone Revenues:			
Exchange Service.....	\$13,281,000	\$13,281,000	\$13,281,000
Toll Service.....	11,113,000	11,113,000	11,113,000
Miscellaneous	316,269	316,269	316,269
Total Telephone Revenues.	\$24,710,269	\$24,710,269	\$24,710,269
Telephone Expense:			
Current Maintenance.....	\$ 3,453,400	\$ 3,453,400	\$ 3,453,400
Depreciation and Amortiza- tion	4,128,000	3,314,716	683,430
Traffic	6,404,465	6,404,465	6,404,465
Commercial	2,657,000	2,657,000	2,657,000
General and Miscellaneous..	589,166	589,166	589,166
Uncollectibles	140,000	140,000	140,000
Taxes	2,269,691	2,371,812	2,700,723
Rent Expense and Deduc- tions	325,744	325,744	325,744
Miscellaneous Deductions...	56,813	56,813	56,813
License Contract Expense..	1,041,695	1,041,695	1,041,695
Total Telephone Expense.	\$21,065,974	\$20,354,811	\$18,052,436
Net Telephone Earnings..	\$ 3,644,295	\$ 4,355,438	\$ 6,657,833
Average Cost... \$86,401,736			
% Return on Avg. Cost	4.22	5.04	7.71
Defendant's Average Fair and Reasonable Value	88,417,448		
% Return on Value	4.12	4.93	7.53"

(italics ours)

* NOTE.—The differences in the tax estimates are due to the reduction of the depreciation expense and consequent increase of net earnings.

The above table shows that, *using the Board's own depreciation expense rates*, the Board computes the necessary and proper depreciation expense for 1925 at \$3,314,716, but further shows that if the whole amount of such expense is charged in that year the Company can earn an annual return of only 4.93% on the value of its property as found by the Board. In order, therefore, that the Company may appear to earn a rate of return which the Board itself states to be fair, namely, 7.53%, it would compel the Company through compliance with its order to charge to depreciation expense only \$683,430 of this \$3,314,716 and, in effect, transfer the difference of \$2,631,286 from expense to earnings, thus "dipping into" the existing depreciation reserve for that amount.

The above table also shows that if the depreciation expense rates which the Company insists are correct are used in making the calculation, the Company would be able to earn only 4.12% on the property value found by the Board; the Company's estimate of depreciation expense being \$813,284 greater than the amount of such expense which results from the use of the Board's depreciation rates. *This makes the total shortage for the year 1925 below a return of 7.53% on the Board's rate base, \$3,444,570 (\$2,631,286 plus \$813,284).*

Further, the court should bear in mind that the Board's average property value for 1925 of \$88,417,448 (R. 211) is nearly \$14,000,000 less than the fair and reasonable value of the property for this year as shown and claimed by the Company in its affidavits (R. 93; Point III *infra*), and that the shortage above stated would be increased if the return were computed upon the actual fair value.

The per cent. return on the intrastate property and business alone is less than on the entire property and business.

The figures given by the Board in the above tables of figures have reference to the entire property, revenues and expenses of the Company in the State of New Jersey used in both intrastate and interstate service. If these figures be

apportioned to intrastate and interstate service respectively, *no matter on what basis*, it is obvious that the percentages of net return would be much smaller upon the *intrastate* property and business when considered alone, as it is not disputed that the interstate business is more profitable than the intrastate business (R. 6, 7, 85-93).

The Company cannot be punished in the manner attempted by the Board for its lawful operations in the past.

The Company contends that there is no justification in law or equity for the treatment of its past expenses which has been attempted by the Board.

Even were there in fact some excess in the reserve account for depreciation (*which there is not*), the Company cannot be penalized for its operations in the past under telephone rates that were lawful at the time *and during a period when no depreciation expense rates had been prescribed by the appellants or their predecessors in office*. The Board did not attempt to fix the depreciation expense rates of the Company until it made the order complained of in this suit and the depreciation expense rates thereby prescribed did not become effective until January 1, 1925, *and were for the future* (R. 16-17).

There is no punitive quality in rate making or rate regulation, and the Board cannot do indirectly what it cannot do directly. Whatever may have been accumulated in the past under telephone rates and practices then lawful is the property of the Company and entitled to constitutional protection. As the Court below said, "it is essential to remember that the property upon the value of which the plaintiff is entitled to a non-confiscatory return is the property (*not part of it*) that is being used in the service as of the time the inquiry regarding the rates is made" (R. 238-239). (Italics ours.)

Newton v. Consolidated Gas Co., 258 U. S. 165, 175;

Knoxville v. Knoxville Water Co., 212 U. S. 1;

Galveston Electric Co. v. Galveston, 258 U. S. 388;/

Monroe Gaslight & Fuel Co. v. Mich P. U. Com.,
292 Fed. 139;

*Garden City v. Garden City Telephone, Light & Mfg.
Co.*, 236 Fed. 693.

In *Newton v. Consolidated Gas Co.*, *supra*, this Court said at page 175:

"Since 1907 the Gas Company has been subject to supervision by a Commission empowered to prohibit unreasonable rates and the presumption is that any profits from its business were lawfully acquired. *Municipal Gas Co. v. Public Service Commission*, 225 N. Y., 89, 99, 121 N. E. 772. Mere past success could not support a demand that it continue to operate indefinitely at a loss. The public has no such right in respect of private property although dedicated to public use. When it became clear that the prescribed rate had yielded no fair return for more than a year and that this condition would almost certainly continue for many months the Company was clearly entitled to relief."

In *Monroe Gaslight & Fuel Co. v. Michigan P. U. Commission*, *supra*, the statutory court (Denison, C. J., and Tuttle and Simons, D. JJ.) said, in speaking of the depreciation reserve of the plaintiff in that suit:

"The existence of such a surplus on the books has little evidential force. It means only that at the rates which have been charged, the company has collected that amount in addition to what now appears to be the true amount of depreciation plus the amount which it has seen fit to pay out in fixed charges and dividends, or carry as surplus and undivided profits. The idea that such a depreciation account or retirement reserve, which grew up through the collection of lawful rates, is some sort of a trust fund in which the rate payers are interested and upon which the Utility has no right to earn a return, which idea has found favor with some Commissions (although the Michigan Commission has not indicated its adherence thereto) is without foundation. The fact that such excess, along with what is called surplus or undivided profits, has been invested in further

property, does not deprive the Utility of its full right to earn a return thereon. Past high profits, under a contract or under public supervision, form no obstacle to enjoining a later noncompensatory rate (the Consolidated Gas Case); and it can make no difference whether they have been paid out in dividends and reinvested as additional capital, or have been directly reinvested" (p. 147).

In *Garden City v. Garden City Telephone, Light & Mfg. Co.*, 236 Fed. 693 (Circuit Court of Appeals, 8th Circuit), the head note reads:

"In determining the validity of an ordinance fixing rates to be charged by an electric company, claimed to be unconstitutional as confiscatory, the capital on which the company is entitled to a fair return is the reasonable value at the time of the property being used in the service, and it is immaterial that such property was in part acquired or paid for out of previous earnings of the business, or whether or not previous rates were reasonable or excessive."

It is interesting to note that the Board, in its order, recognizes this rule of law in so far as the rates for telephone service are concerned, and invokes it against the claim of the Company that it was not able to earn a fair return under the enjoined rates during the years 1921 to 1924, both inclusive. See the Board's opinion where it says (R. 52):

"Where a utility neglects to apply for an increase in rates to which it is entitled the fault is its own. (*Knoxville v. Knoxville Water Co.*, 212 U. S. 1; *Galveston Electric Co. v. Galveston*, 258 U. S. 388)."

What the Board fails to recognize and point out is that the *Knoxville* case holds the same rule applicable to the depreciation charges. After saying in that case (p. 13) that a water plant begins to depreciate in value from the moment of its use and that, before coming to the question of profit at all, the Company is entitled to earn a sufficient sum annually to make good the depreciation and replace parts of

the property when they come to the end of their useful life, thereby making provision out of earnings for the replacement of the property; and after further pointing out that it is not only the right of the Company to make such provision but its duty, both to the investors and the public, this Court says at page 14:

✓ *"If, however, the company fails to perform this plain duty and to exact sufficient returns to keep the investment unimpaired, whether this is the result of unwarranted dividends upon over-issues of securities, or of omission to exact proper prices for the output, the fault is its own. When, therefore, a public regulation of its prices comes under question, the true value of the property then employed for the purpose of earning a return cannot be enhanced by a consideration of the errors in management which have been committed in the past."* (Italics ours.)

In other words, if in the instant case the depreciation balance were less than adequate, for whatever reason, the Company would not be permitted to charge telephone rates for the future sufficiently high to enable it to make up this deficiency out of its future earnings. It would be allowed rates that were currently adequate and no more and if it desired to replenish its depreciation account it would be obliged to do so out of its surplus or at the expense of its stockholders in the form of reduced dividends. We concede that such is the law. *But the rule must work both ways.* If the Company did now have, in fact, an excess in its depreciation account (*which it has not*), it is an amount that was charged against its revenues derived from lawful telephone rates and was lawfully reserved.

The case in this Court of *Louisiana Railroad Commission v. Cumberland Tel. Co.*, 212 U. S. 414, is cited by the appellants in their brief but is not in point. There was there no attempt, as here, to absorb an alleged excess in the existing depreciation balance to make up an admitted shortage in annual earnings. In that case the Court had before it no question of valuation of the property of the company, as the com-

pany claimed only a fair return on the amount of its capital stock outstanding. The Court's decision is only to the effect that the burden of proof was on the company to show that no part of the depreciation balance had been diverted from this account to create a part of its capital stock. Prior to the decision in the *Cumberland* case and before the accounting rules were adopted, some companies had declared stock dividends out of "depreciation reserve". The opinion recognized the impropriety of any diversion of the accumulated reserve account, and with that the practice of the Company and the accounting rules of the Interstate Commerce Commission are in strict accord.

It may be worth while to point out that the *Knoxville* case reported in the same volume (212 U. S. 1) and the *Cumberland* case were both decided in the year 1909, before the Interstate Commerce Commission took jurisdiction over telephone companies and before the accounting rules were adopted. In the *Knoxville* case, this Court had made an important pronouncement on the subject of depreciation. The accounting rules of the Interstate Commerce Commission, adopted soon after the *Knoxville* and *Cumberland* decisions, established the accounting principles to be followed and prohibit any such practice as is condemned by the opinion in the *Cumberland* case. The rules of the Interstate Commerce Commission have carried out the principles of both the *Knoxville* and *Cumberland* decisions.

A similar proposed treatment by a state Commission of an alleged excess in the depreciation account of the Company was before this Court in Prendergast v. New York Telephone Co., 262 U. S. 43.

In 1922 the Company secured an injunction from the District Court for the Southern District of New York against the Public Service Commission of New York to restrain a reduction in rates ordered by that Commission. In justification of the attempted reduction the Commission presented to the court affidavits upon which it was argued that the depre-

ciation expense of the Company had been too large in the past and that the balance in the reserve account was excessive and should be reduced. One affidavit was made by Mr. James G. Wray who is acting as an expert for the Board in this suit. Mr. Wray there, as in this case, estimated a composite rate of depreciation arrived at by applying his revised schedule of depreciation rates to the various classifications of the Company's property and alleged that an excessive reserve had been built up. He then stated that,

X | "because the Company has already accumulated a reserve for New York City of \$14,000,000 more than is required, the annual allowance for depreciation should be not 4.56% but 3.94% in order that during a long period of years the amount in the depreciation reserve may be gradually brought back to normal; that the charges for depreciation made by the Company in 1921 for the property in New York City are at least \$2,000,000 in excess of normal requirements, and that the expenses can be reduced by at least this amount. * * * If no charges for depreciation should be made in the expenses until such time as the Company's depreciation reserve has been brought down to normal proportions, the expenses for the year 1921, as claimed by Mr. Wiley in his affidavit, will be reduced by \$10,465,722, and the net telephone revenue increased by the same amount, thus increasing to 8.09% the percent net annual revenue computed on the Company's basis. *It is estimated that by eliminating altogether for a period of two or three years the charges for depreciation, the depreciation reserve can be brought down to a normal basis.*" (Italics ours.)

X In addition to Mr. Wray's affidavit the Commission introduced an affidavit made by Milo R. Maltbie substantially to the effect that the Company should make up shortages in its telephone earnings by not making charges to depreciation expense until the alleged excess in the depreciation balance had been absorbed.

The contention of the defendants in that suit is exactly in line with the action taken by the Board here. The question was argued fully in the New York suit before the stat-

utory court (Judges Hough, Knox and A. N. Hand) both orally and on the briefs, and was decided against the Commission. The Court said:

“Plaintiff has for years charged as expense against gross revenue certain sums to ‘Depreciation and Amortization.’ By so doing a fund has been created for replacements or permanent repairs. For some years past the average depreciation rate for various kinds of equipment or property has not varied much from 5.80%. But not all repairs and replacements are made at once; *i. e.*, if a certain amount of depreciation is charged to Expense in the year 1921, it does not follow that all of such charge is expended in that year. Consequently there arises a ‘Reserve for accrued depreciation,’ or, what may be called,—a balance of unexpended depreciation reserve. *This balance now held by plaintiff has reached a much larger sum than the Public Service Commission thinks should exist.* Therefore it is asserted, in justification of the orders complained of that plaintiff should lower its rate of depreciation so as to set aside for (say) the year 1922, \$3,000,000, less than did the rate of 1921 and preceding years. *This bookkeeping measure would of course increase net income by the sum just stated.*” (Italics ours.)

The Court rejected this contention and then further said:

“It is now, however, not denied that the depreciation charges producing the present accumulations, *were lawful when made and as made*, and as such they have passed into the general mass of defendant’s property.” (Italics ours.) (*New York Tel. Co. v. Prendergast*, U. S. Dist. Ct. S. D. N. Y., In Equity, No. 23-252, not reported officially).

The Commission took an appeal to this Court and the question was here again argued both orally and on the briefs. This Court, without discussing the point in its opinion, affirmed the order of the trial court. (262 U. S. 43.)

[The references to the affidavits of Messrs. Wray and Maltbie will be found at pages 127 to 141, and the quotations from the opinion of the statutory court at pages 183 and 184

of the Transcript of Record before this Court in that suit. The argument of the City of New York will be found at pages 24-27 of its brief, and the argument of the Commission and the Attorney General at pages 39-42 of the joint brief filed on their behalf.]

The Board's treatment of the alleged balance in the depreciation account would, if enforced, require the Company indirectly to make charges against it not permitted by the Uniform System of Accounts prescribed by the Interstate Commerce Commission.

In order to comply with the Board's order the Company would have to divert and use its depreciation expense for the purpose of *artificially* creating net earnings sufficient to make up any shortage under a fair return upon the value of its property which the enjoined telephone rates failed to earn (Bill, R. 13; Affidavits, R. 138). The Board proposes by this process to absorb such part of what it states to be the *proper* annual expense of depreciation to the extent necessary to make the annual net return of the Company equal to 7½%.

This treatment of the balance in the reserve account for depreciation would be in direct violation of the Uniform System of Accounts prescribed by the Interstate Commerce Commission. Under that System of Accounts the only charges that can be made against this account are for property retired from the plant at the time such property is actually removed from service. (R. 131-139.) The amount so charged is the original cost of the property less any salvage realized. The order of the Board would compel the Company to charge to the account any deficiency in earnings in any year below the amount of earnings found by the Board to be fair, such charges to continue until in that way the sum of \$4,750,000 (the alleged excess in the account) shall have been absorbed. It is true that the Board does not accomplish this by requiring the deficiency of earn-

ings to be entered directly upon the books as a charge against the depreciation reserve account, but instead treats it as a current reduction in the amount to be credited to it. However, it is manifest that the net result is as we have stated, namely, to write out of the account \$4,750,000 that is now in it (R. 134-138).

POINT II.

The Company's charges for depreciation expense are regulated by the Interstate Commerce Commission and its jurisdiction is exclusive; the order of the Board is, therefore, invalid and its enforcement was properly enjoined.

The court below did not, in its opinion, pass upon this question. Since, however, this is a wholly independent and separate ground which, if our views of the law are correct, is decisive of the case and would lead necessarily to an affirmance without regard to any other question, we renew the point here.

The Company pleaded the point by appropriate averments in its bill of complaint, Sections XVI to XXIII, both inclusive. These averments show that the whole matter of depreciation charges and accounting has been committed by Congress to the Interstate Commerce Commission, which has regulated the subject comprehensively ever since January 1, 1913, and that the Board is without authority in the premises and its order constitutes an unlawful interference with interstate commerce (R. 8-13).

It is clear, beyond dispute, that the telephone rates required by the Board's order cannot stand if the provisions of the order respecting depreciation are void.

The Board takes the whole matter of depreciation expense accounting out of the hands of the management, and

the regulation of it out of the hands of the Interstate Commerce Commission. It assumes to fix the annual expense rate for each class of property to the exact one-hundredth of one per cent. (Board's finding No. 4-c, R. 60-1). Then, moreover, it does not permit the Company to charge even these inadequate rates, but orders the Company to reduce the charges by whatever amount the earnings fall short of a fair return (as determined by the Board). This is to be continued until the alleged excess of \$4,750,000 is absorbed. The order provides:

"When the total deductions from the normally required depreciation expense shall have aggregated a total of \$4,750,000 such deductions shall be no longer made" (R. 61).

The Board exercised an authority it did not have (1) when it reduced the Company's depreciation rates, and (2) when it further reduced the charges to make up the admitted deficiency in earnings. By fixing telephone rates on this basis it deprived the Company of a bare fair return in the amount of \$2,074,000 for the year 1924 (\$1,300,000 + \$774,000), and \$3,444,570 for the year 1925 (\$2,631,286 + \$813,284), upon its own figures (see *supra*, pp. 17 and 21).

If the Company kept its books in compliance with this order they would show earnings for 1924 and 1925 in excess of the amounts actually earned by the sums stated.

The Company cannot comply with any of these provisions without violating the orders of the Interstate Commerce Commission and laying itself liable to drastic penalties.

Exclusive Jurisdiction of Interstate Commerce Commission.

Section 1 of the Interstate Commerce Act, as amended, provides "That the provisions of this Act shall apply to common carriers engaged in * * * the transmission of intelligence by wire or wireless; * * * from one state * * * to any other state" etc. It provides further that "the term 'common carrier' as used in this Act shall include * * * telegraph, telephone and cable companies operating

by wire or wireless." The Act further defines the term "transmission" as including all instrumentalities and facilities employed therein (41 U. S. Stat. L. 456, 474).

This Company is such a common carrier. It affords to its patrons and at all its telephones connections not only with all other telephones in its own system in the States of New Jersey, New York and Connecticut, but also connections with the telephones of other companies throughout the United States. In other words, its entire system is available to its patrons simultaneously at all times for both intrastate and interstate communications, and is being used continuously for both classes of communications. In that respect, its plant is similar to that of a large railroad system. The same telephones, wires, switchboards, buildings, etc., are used for both classes of transmission, just as a railroad employs the same right-of-way, ties, rails, rolling stock and buildings for hauling freight and passengers in both classes of transportation.

There can be only one correct rate of depreciation applicable to any class of property. Because the whole property is devoted to interstate commerce (although being also devoted to intrastate commerce) the federal power to regulate interstate commerce attaches to the whole property, and that power has been and is being exercised.

The Interstate Commerce Commission, by an order entered December 10, 1912, effective January 1, 1913, adopted and promulgated the "Uniform System of Accounts for Telephone Companies" (Class A and B) (R. 139).

That order has remained in effect ever since, and since January 1, 1913, the Company has kept, and now keeps, its accounts in accordance with it.

The Uniform System of Accounts for Class A and B Telephone Companies, together with the interpretations and rulings made by the Interstate Commission since it was prescribed in 1912, includes a complete and comprehensive regulation of the subject of depreciation accounting.

Account No. 608, "Depreciation of Plant and Equipment", an operating expense account, Account No. 340, "Amortization of Landed Capital", and Account No. 102, "Reserve for Accrued Depreciation", are created. Regulations covering entries to be made in connection with fixed capital withdrawn or retired are set forth. Under the heading "Instructions Pertaining to Operating Expense Accounts," the explanatory text deals in detail with the subject. Extraordinary repairs, as distinguished from ordinary repairs, are defined and their treatment in relation to depreciation accounting covered. The elements that comprise expense of depreciation are enumerated. *The accounting company is directed to base its depreciation charges upon rules to be determined by itself, but these rules must be derived from a consideration of the company's history and experience, and it is provided that the company must be prepared at all times to justify the charges made for depreciation by furnishing to the commission upon demand a sworn statement of the facts, expert opinions, and estimates upon which they are based.* These charges are not to be made in lump sums but are to be spread over a period which is defined. Various appropriate accounts are prescribed and designated by number and name.

We do not deem it desirable to burden this brief with a reprint of the provisions above referred to, but we wish to direct special attention to the full text of Section 23 which appears in the record, page 140.

The provisions may be summarized as follows. At all times since January 1, 1913:

(1) Depreciation has been authoritatively defined by the Interstate Commerce Commission to include the using up of property in service ("capital consumed in operations")

from all causes whatever—wear and tear not covered by current repairs, obsolescence, inadequacy, public requirements, and extraordinary casualties (R. 140).

(2) The property so used up is an expense of operation, and its cost less salvage measures the amount of this expense (R. 140).

(3) This expense is to be charged by the company from month to month at rates per cent. based upon the average service lives and salvage of the respective classes of the depreciable property, thus to distribute the expense evenly throughout the service life of the property (R. 140).

(4) The Company has been required by law to determine its current charges for depreciation expense by rules derived *by the Company* from a consideration of its own history and experience, *and to stand ready at all times to justify the charges as made and reported to the Interstate Commerce Commission by the sworn statements of the facts, expert opinions and estimates upon which they have been based* (R. 140).

We digress at this point in our statement of the facts regarding federal regulation to point out how impossible it is to reconcile what the Board has done by its order with these requirements of the Interstate Commerce Commission. The Board takes the matter out of the hands of the Company and out of the hands of the Interstate Commerce Commission and fixes the rates of depreciation expense, and requires the Company to make the entries upon its books in accordance with its order, under the pain of penalties provided in the statutes of New Jersey for a violation of an order of the Utility Board.

The Company shows that it cannot justify those rates and that if it should charge and report them to the Interstate Commerce Commission, and should be called upon by that Commission to support them upon "a sworn statement of the facts, expert opinions, and estimates upon

which they are based" it would be unable to do so, and would be obliged to make oath that they are wrong and entirely insufficient (R. 123).

It is equally clear that it cannot comply, and should be protected by injunction from being forced to comply, with the other provisions of the order dealing with the same subject, particularly the provision that in effect requires the Company to charge operating deficits against the book account for depreciation, to the extent of \$4,750,000. The orders of the Interstate Commission do not permit this to be done. The Uniform System of Accounts definitely provides what shall constitute proper charges against the depreciation account and nothing else can be charged against it. This is shown in the affidavit of Andrew Sangster on Depreciation Accounting, where the provisions of the accounting system are set forth under Account 102 "Reserve for Accrued Depreciation", the second paragraph of which deals with charges to this account (R. 138). The substance of that paragraph, stated in nontechnical language, is that there shall be charged against the account the cost of property retired at the time of its retirement. No other charge is permitted.

Returning from this digression, Congress amended the Interstate Commerce Act by an amendment (41 U. S. Stat. L. 456; 493) to Paragraph 5 of Section 20, approved February 28, 1920, effective on that date, so that it now reads as follows, the amendment being the part in italics:

"Interstate Commerce Act

Paragraph (5) of Sect. 20.

"The Commission may, in its discretion, prescribe the forms of any and all accounts, records, and memoranda to be kept by carriers subject to the provisions of this Act, including the accounts, records and memoranda of the movement of traffic, as well as of the receipts and expenditures of moneys. *The Commission shall, as soon as practicable, prescribe, for carriers subject to this Act, the classes of property for which depreciation charges may properly be included under operating expenses, and the percentages of depreciation which shall*

*be charged with respect to each of such classes of property, classifying the carriers as it may deem proper for this purpose. The Commission may, when it deems necessary, modify the classes and percentages so prescribed. The carriers subject to this Act shall not charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the Commission. No such carrier shall in any case include in any form under its operating or other expenses any depreciation or other charge or expenditure included elsewhere as a depreciation charge or otherwise under its operating or other expenses. * * *, and it shall be unlawful for such carriers to keep any other accounts, records or memoranda than those prescribed or approved by the Commission, * * *."*

It will be observed that the amendment directs the Interstate Commerce Commission, as soon as practicable, to prescribe the depreciation expense rates to be charged. It is our view that the significance of this amendment lies only in the *mandate* to the Interstate Commerce Commission, that is, in the *direction* to fix the rates. Whether we are right or wrong about that would not change the result in this case.

After this amendment was passed the first significant action taken by the Interstate Commerce Commission was to issue on March 18, 1920, and serve upon the carriers, including this plaintiff, the following order (R. 142) :

"INTERSTATE COMMERCE COMMISSION
Washington

MARCH 18, 1920.

"To All Carriers Concerned :

"Section 435 of the Transportation Act, 1920, contains the following provision :

"The Commission shall, as soon as practicable, prescribe, for carriers subject to this Act, the classes of property for which depreciation charges may properly be included under operating expenses, and the percent-

ages of depreciation which shall be charged with respect to each such classes of property, classifying the carriers as it may deem proper for this purpose. The Commission may, when it deems necessary, modify the classes and percentages so prescribed. The carriers subject to this Act shall not charge to operating expenses any depreciation charges on classes of property other than those prescribed by the Commission, or charge with respect to any class of property a percentage of depreciation other than that prescribed therefor by the Commission. No such carrier shall in any case include in any form under its operating or other expenses any depreciation or other charge or expenditure included elsewhere as a depreciation charge or otherwise under its operating or other expenses.

"Information received by the Commission indicates the existence of doubt as to the propriety of carriers making any charges to operating expenses with respect to depreciation prior to such time as the Commission shall prescribe the specific percentage of depreciation which shall be charged.

"The purpose of this circular is to dispel any such doubts as may exist in the minds of accounting officers.

"Until the Commission shall otherwise order, all carriers subject to the Act to regulate commerce should continue to observe the requirements respecting the accounting for depreciation which are embodied in the effective accounting classification prescribed by the Commission for the respective classes of carriers.

GEORGE B. MCGINTY,
Secretary."

The gist of this order is to direct the companies to continue to comply with the Uniform System of Accounts until the further order of the Commission.

No further order has as yet been made, but the Interstate Commerce Commission has been engaged diligently in carrying out the mandate of the amendment. Divers and extended investigations have been conducted, and several hearings have been held to that end, as shown by our bill of complaint, Paragraph XVII (R. 11). The Company is awaiting the further action of the Commission.

That in this situation the Company cannot comply with the provisions of the Board's order, that such order is void for want of jurisdiction over the subject matter, and is an unlawful interference with interstate commerce, and that the Company is entitled to the injunctive protection which it seeks, seems to us to be entirely clear.

Any possible doubt there might have been as to the authority of the Interstate Commerce Commission to make and enforce such regulations as these was set at rest by this Court in *Interstate Commerce Commission v. Goodrich Transit Company*, 224 U. S. 194, decided April 1, 1912, a few months, it will be noted, before the Interstate Commerce Commission prescribed the Uniform System of Accounts for Telephone Companies. That case pertinently calls attention to the other powers and duties of the Interstate Commerce Commission and to the requirement of annual reports and other reports by the carriers and, in that connection, points out the necessity for uniformity in the accounts. Manifestly, if depreciation may be accounted for on one basis laid down by one state commission and different and varying bases laid down by other state commissions, the statements of the carriers' financial condition shown in their reports to the Interstate Commerce Commission will mean nothing.

This practical construction of the Interstate Commerce Act has not been seriously questioned, so far as we know, and the jurisdiction of the Interstate Commerce Commission over these matters has been uniformly acquiesced in by state commissions throughout the country, including the New Jersey Board.

The rule that the long continued practical construction of an Act of Congress by a department of the Government, long acquiesced in by one now complaining, will be usually decisive as to the correct construction, is familiar law. That this principle applies to a construction placed by the Interstate Commerce Commission upon provisions of

the Interstate Commerce Act (as well as to that of executive and administrative departments) is settled by *New York, New Haven and Hartford Railroad Co. v. Interstate Commerce Commission*, 200 U. S. 361. Other cases are the following:

United States v. Cerecedo Hermanos y Compania,
209 U. S. 337;

United States v. G. Falk & Bro., 204 U. S. 143;

United States v. Philbrick, 120 U. S. 52;

National Lead Co. v. United States, 252 U. S. 140;

Postal-Telegraph Cable Co. v. Warren Godwin Co.,
251 U. S. 27.

The controlling principles are familiar; that where the Federal power enters it dominates; there can be no conflict of jurisdiction; the fact that the exercise of the Federal power operates upon intrastate facilities and business of the carriers is no objection to its exercise; whether there is an actual antagonism between the state and Federal statutes or not, the state cannot enter the field occupied by the Federal jurisdiction for the purpose of supplementing Federal action. There are border line cases, but the facts here present no such case.

Northern Pacific R. Co. v. Washington, 222 U. S.
370;

Erie R. Co. v. People, 233 U. S. 671;

Southern R. Co. v. Reid, 222 U. S. 424;

Adams Express Co. v. Croninger, 226 U. S. 491;

Chicago, R. I. & P. Railway Co. v. Hardwick Elevator Co., 226 U. S. 426;

St. Louis, I. M. & S. Ry. Co. v. Edwards, 227 U. S.
265;

McDermott v. Wisconsin, 228 U. S. 115;

Michigan Central R. Co. v. Vreeland, 227 U. S. 59;

Taylor v. Taylor, 232 U. S. 363;

Southern R. Co. v. Indiana, 236 U. S. 439;

Charleston & C. R. Co. v. Varnville Furniture Co.,
237 U. S. 597;
Texas & Pacific R. Co. v. Rigsby, 241 U. S. 33;
New York Central R. Co. v. Winfield, 244 U. S. 147;
Pennsylvania R. Co. v. Public Service Commission,
250 U. S. 566;
Postal Telegraph Cable Co. v. Warren Godwin Co.,
251 U. S. 27.

The act applies to the property as a whole and to all its parts and only one depreciation charge can be applied.

The *transmission* (messages) can be and is divided into interstate and intrastate transmission, subject to regulation by Congress and the state legislatures respectively. But the whole *property* is devoted to both services and *cannot be divided*.

There is no dispute whatever about the *facts* in this respect, and could be none. Everyone knows, for example, that a man having one of the Company's telephones in Hoboken may call central to talk to another telephone in Hoboken—a transaction in *intrastate* commerce, which utilizes the telephone instrument, the wires, poles, crossarms, conduits, cables, central office switchboard, central office building, etc., the whole telephone mechanism. The Hoboken subscriber may next call central for a connection directly across the river with a telephone in New York City and upon obtaining such connection the whole property is used in an *interstate* transaction.

But the life in service of each one of the enumerated parts of the plant is a unit and cannot be divided into an interstate life and an intrastate life. The salvage that will be recovered when the unit is retired from the plant for any cause is a unit and cannot be divided. These service lives and the salvage determine the depreciation rate, and the rate cannot be divided. The depreciation rate, therefore,

cannot be regulated by both the state and federal governments at the same time. One of them must yield and, of course, it is the state authority that must yield. *The segregation of values* on the basis of relative use in interstate and intrastate commerce, for the regulation of rates for the service, is an entirely different thing. That can be and is made.

The Interstate Commerce Commission requires the depreciation expense to be accounted for on a company-wide basis and without reference to state lines. The Company owns and operates telephone plant in three states, New Jersey, New York and Connecticut. If the New Jersey Board has jurisdiction over this subject, the New York Commission likewise has, and the Connecticut Commission; and the Company will be subjected to three sets of regulations, three different schedules of rates. While the New Jersey Board at present seems to accept the straightline method, the New York and Connecticut Commissions may prefer the sinking fund method or some other of the many methods which have their supporters. Even if they agreed as to the method they would disagree as to the rate. If these things may be done with respect to telephone companies, they may also, as a matter of law, be done with respect to railroads.

For the reasons above stated in this point the order of the Board is void.

POINT III.

Without regard to the questions argued in the foregoing points the preliminary injunction properly was granted upon all the evidence before the Court below.

1. The order of the Board if enforced would confiscate the property of the Company by reducing its value more than \$14,000,000. The Board erred both in law and in fact in its finding as to the value of the property.

The average value figure for 1924 found by the Board is \$76,370,000 for the total property, both intrastate and interstate (R. 32), which is but slightly over the average *cost* figure for that year—\$76,247,000 (R. 92). The Company's average value for that year is \$91,000,000 (R. 92).

It appears from the decision of the Board that while it professes to have taken note of the rule of *present value* announced in *Smyth v. Ames*, 169 U. S. 466 (R. 27), it did not give due weight and consideration to the rules of valuation established by the later cases. Its decision (Table, R. 25) shows the value of the entire property in New Jersey on June 30, 1924, as claimed by the Company based on reproduction cost less depreciation. These figures are compared below with the value as of the same date found by the Board (R. 32):

	Company's figures	Board's figures	Amount allowed the Board
Tangible Fixed Capital, Depreciated	\$74,041,743	\$71,000,000	\$ 3,041,743
Going Value.....	11,782,000	3,600,000	8,182,000
Working Capital.....	2,571,900	1,770,000	801,900
Construction in Progress.....	2,190,425	disallowed	2,190,425
Totals.....	<u>\$90,586,068</u>	<u>\$76,370,000</u>	<u>\$14,216,068</u>

The Company contends that there was no justification whatever for this disallowance of more than \$14,000,000 of value and that the Board erred both in law and in fact in so doing.

We will discuss briefly the errors committed by the Board in reducing and disallowing the value of the items referred to in the above table:

A—Tangible Fixed Capital.

The Board disallowed \$3,041,743 of the value of this item as shown in the Company's appraisal. The figure arrived at by the Board is a compromise between several figures (see Table, R. 25). The appraisal made by the Company was practically unchallenged and even the modification of the Company's figure as made by Mr. Wray (one of the Board's engineers) gives a result \$533,673 higher than the value found by the Board (R. 25). The modification made by Mr. Wray was based upon an arbitrary assumption that in estimating the cost of reproduction the Company's engineers had not sufficiently taken into consideration the economies obtainable if the plant were to be reproduced as an entirety (R. 23).

B—Going Value.

The Board disallowed \$8,182,000 of going value. No estimate of going value was made by the Board's engineers. There was no evidence submitted to the Board except that introduced by the Company which consisted of an estimate by its Valuation Engineer, Mr. Whittemore, based on reproducing the business and organization of the Company, and the testimony of Mr. William H. Blood, Jr., an engineer of wide experience, as to the amount which, in his opinion, should be allowed. Affidavits by Messrs. Whittemore and Blood, similar to the evidence given by them before the Board, are among the supporting affidavits in this suit (R. 80, 81, 114, 115). The evidence of Messrs. Whittemore and Blood was uncontradicted but the Board preferred to make

its finding as to going value "by the exercise of ordinary business judgment" (R. 28). This can be interpreted only to mean that the Board contends that it may make an estimate of going value on a purely arbitrary basis without regard to the evidence before it. This is contrary to judicial decision.

Ohio Utilities Co. v. P. U. C. of Ohio, 267 U. S. 359, 362.

Westinghouse El. & M'fg Co. v. Denver Tramway Co., 3 Fed. (2d) 285, 298.

C—Working Capital.

The Board disallowed \$801,900 of the working capital shown in the Company's appraisal. The Company's estimate of working cash was based on the actual amounts carried by the Company for several years preceding (R. 80), supported by the testimony of a Vice President of the Company that the maintenance of such cash balances was necessary for the proper management of the business (R. 30). The Board's expert, who admitted that he had had no experience in financial management, arbitrarily reduced the amount of working cash by about sixty per cent. and upon this opinion the Board based its finding. This was a clear attempt to usurp the discretion and powers of the Company's managers.

D—Construction in Progress.

The Board excluded all construction in progress, the amount being \$2,190,425 (R. 24-25). The Company claimed that the amount represented by work in progress should bear a full return, credit, however, being allowed for interest during construction (R. 24). Dollars which have been invested in plant not yet in service have been as irrevocably committed to the enterprise as the dollars invested in completed plant and no distinction should be made as to the return thereon. *The Board did not question the amount involved nor did it claim that such construction was unnecessary or improper.*

Ohio Utilities Co. v. P. U. C. of Ohio, supra.

The Board's erroneous valuation prevents the Company from earning on a proper rate base:

The Company is confident that it can establish upon the trial with detail proof the value of its property set forth in its Bill (R. 6-7) and affidavits (R. 81-2) and also the amount of the additions thereto made since June 30, 1924. In view of the opposing contentions of the parties the fair and reasonable value can be established definitely only on the trial but the Company should not in the meantime be subjected to an irreparable loss of return upon \$14,000,000 of property if its contentions are correct. At the rate of return found by the Board to be fair ($7\frac{1}{2}\%$) such loss would amount to \$1,050,000 annually.

2. The Board did not meet the proof of the Company as to the cost and value of its intrastate property or as to the results of the operation of its intrastate business under the telephone rates enjoined.

There was a complete failure on the part of the Board to meet the proof of the Company as to the cost and value of its intrastate property and the results of the operation of its intrastate business.

The opposing affidavits make some criticism of the method of separation between intrastate and interstate property and business employed by the Company (R. 221-223). They also enumerate certain classes of service furnished by the Company in addition to its ordinary exchange and toll telephone service (R. 221-223) and state that the property and business of the Company is not limited alone to intrastate and interstate telephone service as alleged in the moving papers. The Company's affidavits did not specify in detail all of the subsidiary classes of service referred to in the Board's affidavits, but all such business is covered by the accounts prescribed by the I. C. C. Accounting System, and a complete list of said accounts is set up in the Company's papers showing the basis of apportionment of each account between the interstate and

intrastate services furnished by the Company. The apportionment shown in the Company's papers covers *all* of the Company's property in the State of New Jersey as well as *all* of the revenues derived from the use of such property and *all* of the expenses incurred in rendering the services (Replying Affidavits, Addition to Record, p. 13).

The apportionment shown in the Company's affidavits (R. 94-103) is made by the same methods and on the same basis as in the two suits of the Company involving its intrastate property and business in the State of New York, brought in the Southern District of New York in 1922 and 1924 (*Prendergast v. N. Y. Telephone Co.*, 262 U. S. 43; *N. Y. Telephone Co. v. Prendergast*, 300 Fed. 822). The method of separation in those suits was criticized by the parties defendant but no better method of separation was suggested. In the latter suit the statutory court said (300 Fed. at p. 827) :

"We see no reason to doubt that the various proratings on interstate business have been properly done."

No better method is suggested by the Board in this suit. The engineer for the Board states that he did not make an independent segregation as he did not have the time or the necessary data and information (R. 214). That the data and information were not refused him appears from the Company's replying affidavits (Addition to Record, pp. 1-5).

In this state of the record the Company's proof as to its intrastate property and business stands uncontradicted and the results of the operations of that business under the enjoined service rates were as stated in the following sub-point.

3. The telephone rates enjoined did not produce and could not produce a fair return upon the value of the Company's property, nor even upon its cost. This is so whether the entire property and business be considered or the intrastate property and business alone.

Return on value:

The percentages of net revenue claimed to have been earned by the Company under the enjoined service rates in the years 1922, 1923 and 1924, and as estimated for the year 1925, to the average fair and reasonable value of the property in those years are as follows:

Year	Entire operations in New Jersey	Intrastate operations in New Jersey
1922	4.34%	0.76%
1923	4.42%	1.10%
1924	3.75%	0.42%
1925 (<i>est.</i>)	3.57%	0.40%

(R. 6, 7, 85-93.)

Return on the Board's valuation:

The net earnings of the Company for the year 1924 under the enjoined rates were \$3,409,000 (R. 92), which is a return of only 4.46% on the value (\$76,370,000; R. 32) of the entire property, both intrastate and interstate, adopted by the Board itself.

Return on Cost:

In 1924 the Company from its entire operations in New Jersey earned only 4.47% on the cost of its property (R. 92) and only 0.50% on the intrastate business alone (R. 87).

The effect of the enjoined service rates during the years 1922 to 1925 inclusive as shown by the Board's affidavits:

In its opposing affidavits the Board sets forth figures (R. 215-218; 211) which purport to show the result of the entire

operations (both intrastate and interstate) upon the basis of the enjoined rates from 1922 to 1925 inclusive, *assuming that its rates for depreciation expense had been in force throughout that period and also assuming the value of the property to be reduced in accordance with its findings.* Its figures even after doing this violence to the actual expense and value show that the highest return to the Company which it can compute was 6.79% in 1922, and that such return has been declining steadily and that by the same process of calculation the net return during 1925 would be only 4.93% (R. 211).

The Company was clearly entitled to interlocutory relief upon such a showing:

The Company's right to a preliminary injunction is clear whether the return is estimated as a percentage of *value* or of *cost*, and whether the test is applied to the entire property and operations of the Company within the State of New Jersey or to the intrastate property and business alone. On either basis, value or cost, the enjoined service rates are confiscatory. They are also confiscatory upon the rate base adopted by the Board.

Under such circumstances a preliminary injunction was properly granted.

The Minnesota Rate Cases, 230 U. S. 352, at pages 470-472;

Missouri Rate Cases, 230 U. S. 474 at pages 507-508.

4. The order of the Board requires the Company to charge for depreciation expense an amount less than the actual expense of depreciation and hence if enforced would work continuing confiscation of the Company's property.

The order of the Board prescribes the rates upon which the depreciation expense of the Company shall be computed after January 1, 1925 (R. 16-17).

In its decision the Board shows the results of the application of its schedule of depreciation expense rates as com-

pared with the Company's schedule when applied to the operations during the year 1924. In the table of figures given by the Board (R. 38) the expense of depreciation in 1924 is stated to be as follows:

Depreciation expense computed at the Company's rates	\$3,452,000
Depreciation expense computed at the Board's rates	2,678,000
	<hr/>
Difference	774,000

In the estimate of operations for the year 1925 given by the Board in its opposing affidavits the expense of depreciation for that year is estimated to be as follows (R. 211):

Depreciation expense computed at the Company's rates	\$4,128,000
Depreciation expense computed at the Board's rates	3,314,716
	<hr/>
Difference	813,284

With the growth of the property these differences will be increased in future years. This requirement of the Board that the Company shall charge to expense so much less than the true amount of expense accruing in each year clearly confiscates the property of the Company in that it will compel the Company to operate without making adequate provision for one of its necessary operating costs.

The determination of proper depreciation rates is peculiarly a question of management:

It involves engineering studies of the Company's actual experience and the exercise of business judgment as to the proper provision to be made for the future. It further involves large questions of policy as to the adoption of new types of equipment to be substituted for existing types. The financial credit of a utility may be seriously affected by the result of this determination. It is highly important

to allow the management a proper discretion, for upon the management rests the responsibility for the utility's financial policy, for the maintenance of its service and for the protection of its property. *Such discretion should not be overridden in the absence of proof that it has been abused.*

There is also an element of sound business judgment as to the amount to be carried in the reserve balance over and above the actuarial or engineering calculations which are the principal bases of the credits to such reserve and the corresponding charges to expense.

In discussing the depreciation expense and the depreciation balance of this Company the statutory court in *New York Telephone Co. v. Prendergast*, 300 Fed. 822, recognized the fact that the book charges for depreciation should represent what the observation and experience of the management "suggested as likely to happen, with some margin over" (p. 825).

This Court in *Southwestern Bell Telephone Co. v. Public Service Commission*, 262 U. S. 276, 277, announced the rule that:

"A State Commission, in fixing the rates of a public utility corporation, cannot substitute its judgment for the honest discretion of the company's board of directors respecting the necessity and reasonableness of expenditures made in the operations of the company."

(Headnote.)

See also,

Banton v. Belt Line R'y Corp., 268 U. S. 413, 421.

Southwestern Bell Telephone Co. v. City of Fort Smith, 294 Fed. 102, 108.

Northwestern Bell Tel. Co. v. Spillman, 6 Fed. (2d) 663, 665.

Obviously, it is to the interest of the management and the Company's stockholders to keep the expenses as low as is consistent with proper maintenance and protection of the property in order that as much revenue as possible may be available currently for dividends, because amounts once credited to the account for depreciation cannot be diverted to any other use.

If the rates prescribed by the Board are insufficient to provide for the currently accruing expense, distributing such expenses as evenly as possible throughout the life of the depreciating property, then the order of the Board would cause the Company to enter upon its books an amount of expense not representative of the true condition and which will not meet the true expense that the Company is incurring. It is the opinion of the Company's managers and engineers that the rates prescribed by the Board would fail substantially to meet the charges properly to be made to expense on account of depreciation losses currently accruing (R. 13; 124). The Board contends that the Company's depreciation rates are too high but such contention is a mere adoption of the opinion of an engineer who has had no managerial nor financial experience.

The Board's order in this regard is illegal:

No abuse of discretion or impropriety upon the part of the Company's management in determining its depreciation expense rates has been shown or suggested and yet the Board has disregarded completely the management's ripened judgment and made an order which, if enforced, would prevent the Company from charging to depreciation expense in the year 1925 upwards of \$813,000 of actual and proper expense. The order of the Board in this regard is quite as illegal and hurtful to the Company's property and interests as the part of the order which prevented any increase in the telephone service rates.

POINT IV.

There was no abuse of discretion by the Court below.

Whether a preliminary injunction should be granted rests in the sound discretion of the statutory court. Except for strong reasons this Court will not interfere with its action.

Prendergast v. New York Telephone Co., 262 U. S. 43, 51-52;

Chicago Great Western Ry. Co. v. Kendall, 266 U. S. 94, 100;

Meccano, Ltd. v. Wanamaker, 253 U. S. 136, 141;

Monroe Gaslight & Fuel Co. v. Michigan P. U. C., 292 Fed. 139, 144-145;

City of Amarillo v. Southwestern Tel. & Tel. Co., 253 Fed. 638, 640;

Van Wert Gaslight Co. v. Public Utilities Commission of Ohio, 299 Fed. 670, 676.

In *Prendergast v. New York Telephone Co.*, 262 U. S. 43, this Court said at pages 50-51:

“It is well settled that the granting of a temporary injunction, pending final hearing, is within the sound discretion of the trial court; and that, upon appeal, an order granting such an injunction will not be disturbed unless contrary to some rule of equity, or the result of improvident exercise of judicial discretion. *Meccano, Ltd. v. John Wanamaker*, 253 U. S. 136, 141; *Lore v. Atchison Railway*, *supra*, p. 331; and cases there cited. Especially will the granting of the temporary writ be upheld, when the balance of injury as between the parties favors its issue. *Amarillo v. Southwestern Telephone Co.* (C. C. A.), 253 Fed. 638, 640.”

In the case at bar there is nothing to suggest an abuse of discretion by the court below. If the preliminary injunction had not been granted the Company would have suffered an

irreparable and substantial loss of revenue. On the other hand, the subscribers have been protected fully by the bond furnished by the Company (R. 243). The Company could only be protected by the preliminary injunction.

Conclusion.

It was the opinion of the statutory court after lengthy argument and due consideration of all the evidence before it that the order of the Board was confiscatory and invalid and that its enforcement should be enjoined pending the trial of the suit (R. 240).

The order of the court below should be affirmed.

Respectfully submitted,

CHARLES M. BRACELEN,
THOMAS G. HAIGHT,
CHARLES T. RUSSELL,
FRANKLAND BRIGGS,
Counsel for Appellee.

SUPREME COURT OF THE UNITED STATES.

No. 567.—OCTOBER TERM, 1925.

Board of Public Utility Commissioners	}	Appeal from the District
et al., Appellants,		Court of the United
vs.		States for the District of
New York Telephone Company.	}	New Jersey.

[April 12, 1926.]

Mr. Justice BUTLER delivered the opinion of the Court.

This is an appeal from a decree of the district court—three judges sitting, § 266, Judicial Code—which granted a temporary injunction restraining the enforcement of certain telephone rates.

The company owns and operates a telephone system in New Jersey, New York and Connecticut. In the territory served in New Jersey there is a number of local areas. Service between telephones in the same area is exchange service, and that between telephones in different areas is toll service. The latter includes both intrastate and interstate business. The system is used to give exchange and toll service to all subscribers. For about 10 years prior to the commencement of this suit the rates in New Jersey remained at substantially the same level. March 6, 1924, the company filed with the Board of Public Utility Commissioners, to take effect April 1, 1924, a schedule providing for an increase of rates for exchange service in New Jersey. The Board suspended the proposed rates pending an investigation as to their reasonableness. December 31, 1924, the increase was disallowed, and the company was required to continue to serve at the existing rates. The Board found that the value of the company's property in New Jersey, as of June 30, 1924, was \$76,370,000; that a rate of return of 7.53 per cent. producing from \$5,750,000 to \$6,000,000 would be a fair return for that year; that the amount charged by the company in 1924 for depreciation, \$3,452,000, was excessive, and that \$2,678,000 was sufficient. And the Board found that net earnings

in 1924 would be \$4,449,000,—less than the fair return by at least \$1,300,000.

The company's accounts are kept according to the uniform system of accounts for telephone companies prescribed by the Interstate Commerce Commission. Charges are made to cover the depreciation in the elements of the plant which for one cause or another will go out of use. These charges are made month by month against depreciation in the operating expense accounts, and corresponding credits are entered in the depreciation reserve account. When a unit or element of the property is retired there is no charge to operating expense, but its original cost less salvage is charged to the reserve account. December 31, 1923, the company's books showed a credit balance in depreciation reserve accounts of \$16,902,530. This was not set aside or kept in a separate fund, but was invested in the company's telephone plant. The Board prescribed a rule for the determination of depreciation expenses to be charged by the company in 1925 and subsequent years. It declared that the credit balance was more than required for the maintenance of the property, and directed that \$4,750,000 of that amount be used by the company to make up deficits in any year when earnings are less than a reasonable return as found by the Board. And it said, "But having made such charges in the past, future charges beginning January 1st, 1925 may be deducted from the normal charge until such time as at least \$4,750,000 of the excess is absorbed as herein after provided." The effect of the order is to require that if total operating expenses deducted from revenues leaves less than a reasonable return in 1925 or a subsequent year, there shall be deducted from the expense of depreciation in that year and added to the net earnings a sum sufficient to make up the deficiency; then, by appropriate book entries, the resulting shortage in depreciation expense is to be made good out of the balance in the reserve account built up in prior years.

On the application for a temporary injunction, the company attacked the findings of the Board as to rate of return, property value, and expense of depreciation. And it contended that the charges on account of depreciation in earlier years were not excessive, and

that in any event the company could not be compelled to make up deficits in future net earnings out of the depreciation reserves accumulated in the past.

The record shows that the rates in effect prior to the temporary injunction were not sufficient to produce revenue enough to pay necessary operating expenses and a just rate of return on the value of the property. There is printed in the margin¹ a statement made by the Board and included in its decision, giving a comparison of results of operation in 1924 under these rates as found by the Board and as estimated by the company. And, in opposition to the motion for the temporary injunction, the Board submitted

Results under Present Rates—Estimated for the Year 1924.

	By Company (Exhibit P-14)	By Board, based on Ex- hibit C-34 modified
Revenues:		
Exchange Revenues	\$11,936,000	\$11,936,000
Mail Revenues	10,465,000	10,465,000
Miscellaneous Operating	257,000	257,000
Total Telephone Revenue	\$22,658,000	\$22,658,000
Expenses:		
Office Expenses	\$5,846,000	\$5,846,000
Commercial Expenses	2,309,000	2,309,000
General and Miscellaneous Expenses	548,000	548,000
Collectible Operating Revenues	150,000	150,000
Taxes and Other Deductions	1283,000	283,000
Current Maintenance	13,230,000	3,230,000
Depreciation	3,452,000	2,678,000
Interest	2,170,000	2,200,000
Balance Revenue, Dr.	965,000	965,000
Total Telephone Expenses	\$18,953,000	\$18,209,000
Total Telephone Earnings	\$3,705,000	\$4,449,000

¹Include a certain portion of depreciation for right of way from clearing accounts.
²Omits concessions (\$102,000) and interest during construction (\$160,727) aggregating \$262,727 in Exhibit C-34.

4 *Public Utility Commissioners et al. vs. N. Y. Telephone Co.*

an affidavit containing a statement² which set forth in detail the estimated results for 1925 based on the same rates. The affidavit shows net additions to the company's property in New Jersey for 1924, amounting to more than \$13,000,000; and the Board calculates the return on \$88,417,448 as the reasonable value of the property. The calculation is made on three bases: (1) depreciation taken at the company's figure, \$4,128,000, (2) depreciation as found by the Board, \$3,314,716, and (3) depreciation allowed by the Board's order, \$683,430. The effect of the order is to deduct \$2,631,286 from operating expenses found by the Board properly chargeable for depreciation in 1925. This deduction is made at the expense of the property of the company paid for out of depreciation reserves built up in prior years. And it has the same effect on net earnings as would the addition of the same amount of revenue received for service. On the basis of the company's estimate of depreciation expense, the return is 4.12 per

²Estimated Rate of Return During Year 1925 under Present Rate Schedule

	Plaintiff's depreciation rate	Board's depreciation rate	Compliance with order of Board
Telephone Revenues:			
Exchange Service.....	\$13,281,000	\$13,281,000	\$13,281,000
Toll Service	11,113,000	11,113,000	11,113,000
Miscellaneous	316,269	316,269	316,269
Total Telephone Revenues.....	\$24,710,269	\$24,710,269	\$24,710,269
Telephone Expense:			
Current Maintenance	\$3,453,400	\$3,453,400	\$3,453,400
Depreciation and Amortization....	4,128,000	3,314,716	*683,430
Traffic	6,404,465	6,404,465	6,404,465
Commercial	2,657,000	2,657,000	2,657,000
General and Miscellaneous.....	589,166	589,166	589,166
Uncollectibles	140,000	140,000	140,000
Taxes	2,269,691	2,371,812	2,700,750
Rent Expense and Deductions.....	325,744	325,744	325,744
Miscellaneous Deductions	56,813	56,813	56,813
License Contract Expense	1,041,695	1,041,695	1,041,695
Total Telephone Expense.....	\$21,065,974	\$20,354,811	\$18,032,430
Net Telephone Earnings.....	\$3,644,295	\$4,355,438	\$6,657,839
Average Cost, \$86,401,736			
% Return on Average Cost.....	4.22	5.04	7.71
Defendant's Average Fair and Reasonable Value, \$88,417,448			
% Return on Value.....	4.12	4.93	7.71

*Allowing a return of 6% on value of property depreciation and amortization expense will be \$2,163,471.

cent.; on the Board's estimate it is 4.93 per cent.; and by increasing net earnings \$2,631,286, as directed by the order, it is made 7.53 per cent. It is conceded that unless, as directed by the Board, depreciation expense is reduced below what the Board itself found necessary and net earnings are correspondingly increased, the rates cannot be sustained against attack on the ground that they are unreasonably low and confiscatory. Appellants do not contend that the rate of return from the intrastate business is or will be higher than that resulting from the company's business as a whole in New Jersey. And the record supports the claim of the company that the intrastate business or that covered by the exchange rates complained of is not relatively more profitable than the other business of the company.

It may be assumed, as found by the Board, that in prior years the company charged excessive amounts to depreciation expense and so created in the reserve account balances greater than required adequately to maintain the property. It remains to be considered whether the company may be compelled to apply any part of the property or money represented by such balances to overcome deficits in present or future earnings and to sustain rates which otherwise could not be sustained.

The just compensation safeguarded to the utility by the Fourteenth Amendment is a reasonable return on the value of the property used at the time that it is being used for the public service. And rates not sufficient to yield that return are confiscatory. *Willcox v. Consolidated Gas Co.*, 212 U. S. 19, 41; *Bluefield Co. v. Public Service Commission*, 262 U. S. 679, 692. Constitutional protection against confiscation does not depend on the source of the money used to purchase the property. It is enough that it is used to render the service. *San Joaquin Co. v. Stanislaus County*, 233 U. S. 454, 459; *Gas Light Co. v. Cedar Rapids*, 144 Ia. 426, 434, affirmed, 223 U. S. 655; *Consolidated Gas Co. v. New York*, 157 Fed. 849, 858, affirmed 212 U. S. 19; *Ames v. Union Pacific Railway Co.*, 64 Fed. 165, 176. The customers are entitled to demand service and the company must comply. The company is entitled to just compensation and, to have the service, the customers must pay for it. The relation between the company and its customers is not that of partners, agent and principal, or trustee and beneficiary. Cf. *Fall River Gas Works v. Gas & Electric Light Com'rs*, 214 Mass. 529, 538. The revenue paid by the customers for service belongs

6 *Public Utility Commissioners et al. vs. N. Y. Telephone Co.*

to the company. The amount, if any, remaining after paying taxes and operating expenses including the expense of depreciation is the company's compensation for the use of its property. If there is no return or if the amount is less than a reasonable return, the company must bear the loss. Past losses cannot be used to enhance the value of the property or to support a claim that rates for the future are confiscatory. *Galveston Electric Co. v. Galveston*, 258 U. S. 388, 395; *Georgia Ry. v. R. R. Comm.*, 262 U. S. 625, 632. And the law does not require the company to give up for the benefit of future subscribers any part of its accumulations from past operations. Profits of the past cannot be used to sustain confiscatory rates for the future. *Newton v. Consolidated Gas Co.*, 258 U. S. 165, 175; *Galveston Electric Co. v. Galveston*, *supra*, 396; *Monroe Gaslight & Fuel Co. v. Michigan Public Utilities Commission*, 292 Fed. 139, 147; *City of Minneapolis v. Rand*, 285 Fed. 818, 823; *Georgia Ry. & Power Co. v. Railroad Commission*, 278 Fed. 242, 247, affirmed 262 U. S. 625; *Chicago Ry. Co. v. Illinois Commerce Commission*, 277 Fed. 970, 980; *Garden City v. Telephone Company*, 236 Fed. 693, 696.

Customers pay for service, not for the property used to render it. Their payments are not contributions to depreciation or other operating expenses or to capital of the company. By paying bills for service they do not acquire any interest, legal or equitable, in the property used for their convenience or in the funds of the company. Property paid for out of moneys received for service belongs to the company just as does that purchased out of proceeds of its bonds and stock. It is conceded that the exchange rates complained of are not sufficient to yield a just return after paying taxes and operating expenses, including a proper allowance for current depreciation. The property or money of the company represented by the credit balance in the reserve for depreciation cannot be used to make up the deficiency.

Decree affirmed.

Mr. Justice STONE took no part in the consideration of this case.

A true copy.

Test:

Clerk, Supreme Court, U. S.